

Entrepreneurial strategies and trust: structure and evolution of entrepreneurial behavioural patterns in "low trust" and "high trust" environments of East and West Europe; part 4, Estonia and Russia

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Entrepreneurial Strategies and Trust

**Structure and Evolution of Entrepreneurial Behavioural Patterns in “Low Trust”
and “High Trust” Environments of East and West Europe**

Part 4: Estonia and Russia

Hans-Hermann Höhmann and Friederike Welter (editors)

Arbeitspapiere und Materialien – Forschungsstelle Osteuropa, Bremen

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Preface

The following two papers presents results from the empirical research carried out in Estonia and Russia within our international project titled “Entrepreneurial strategies and trust: Structure and evolution of entrepreneurial behavioural patterns in East and West European environments” (2001–2003). The project concentrates on the microeconomic level, studying owner-managers and key decision makers in small businesses with up to 50 employees in food industry, business services and trade. Small businesses reflect the impact of domestic environments better than the often internationalised medium and large enterprises. The empirical research consists of three major elements: a standardised survey and case studies of small businesses in both countries, supplemented by interviews with key experts such as ministries, business associations, local governments and banks.

The project includes two East European and three West European countries. Russia and Estonia represent a problematic and a successful transformation process, respectively. Germany, Italy and Great Britain represent different models of West European capitalism, and different trust cultures. The research has been conducted by an international team. Prof. Hans-Hermann Höhmann, Research Centre for East European Studies at the University of Bremen and PD Dr Friederike Welter, Rhine-Westphalia Institute for Economic Research (RWI) in Essen, Germany are the project co-ordinators, team members are Elena Malieva, Teemu Kautonen and Dr. Bernd Lageman. The Russian Independent Institute for Social and Nationalities Problems (RIISNP), represented by Dr Alexander Chepureenko, is the Russian project partner. In Estonia, the research is performed by Prof Urve Venesaar from the Institute of Economics at the Tallinn Technical University. The studies in Italy and Great Britain are conducted by Prof Gabi Dei Ottati, University of Florence and Prof David Smallbone and Fergus Lyon, Centre for Enterprise and Economic Development Research (CEEDR) at the Middlesex University Business School.

We gratefully acknowledge support by the Volkswagen Foundation, which funded this research within its programme “Unity amidst variety? Intellectual foundations and requirements for an enlarged Europe”.

Trust and Entrepreneurial Behaviour in Estonia

The Survey was carried out in Estonia together with Germany and Russia under the project “Entrepreneurial strategies and trust. Structure and evolution of entrepreneurial behavioral patterns in ‘low-trust’ and ‘high-trust’ environments of East and West Europe”. The project was financed by the VW-Foundation within the research programme “Unity amidst Variety? Intellectual Foundations and Requirements for an Enlarged Europe”.

The Survey was conducted mainly in two stages based on face-to-face interviews and a small number of case studies to specify the issues under study, i.e. inter- and intra-firm relations and relations with third party intermediaries, forms of co-operation, regulation and business environment. Also conversations and discussions with specialists from various institutions (e.g. the Tax Board, Customs Office, City Court, Ministry of Social Affairs, Chamber of Commerce and Industry, Business Register) were arranged to specify the contents and effect of various regulations on the behaviour of enterprises. The interviews with owner-managers of small businesses with up to 50 employees were carried out in summer 2002. Firms for interviews were selected mainly on the basis of sector (food industry, business services and trade) and size (1–9 employees and 10–49 employees). Therefore the sample is not representative of the small business sector, as the aim was to study different trust milieus (national, sectoral, size- and firms’ age related etc).

The survey consisted of 105 enterprises from three sectors, divided almost equally across micro and small enterprises. The third feature considered was enterprise age (i.e. young – 0–5.5 years and old – over 5.5 years). Similar sampling was used in finding firms for case studies, i.e. sector, size, age were considered. These were selected mainly from among enterprises that had been interviewed already during the first stage.

The enterprises which were interviewed were mainly from Tallinn and its close vicinity. This is the region where nearly half of all enterprises active in Estonia are located (although 29% of the total population lives here). This area is characterised by tougher competition, higher market demand and more developed infrastructure, but also a less stable environment than the rest of the country (small towns, rural areas). Therefore, this area is probably less stable than the rest of the country as far as business relations and trust are concerned.

Survey report

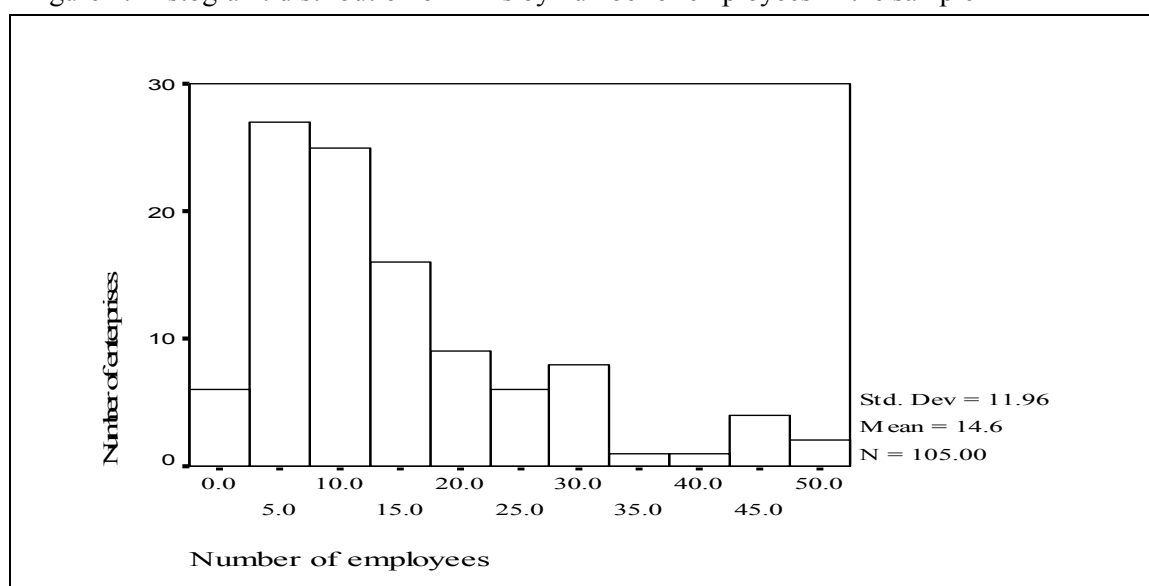
Profile of surveyed enterprises

Sectoral distribution, age and size

A sample of the survey includes 105 private enterprises of 3 sectors: 30 in the food processing sector, 37 in trade (retail and wholesale trade) and 38 in business services. There are 48 (46%) micro enterprises (0–9 employees), and 57 (54%) small enterprises (10–49 employees) in the sample. The histogram of firm distribution shows that the majority of firms is concentrated on the left side between 5 and 20 employees per firm. An average size of firm by mean is 14.6 (and median is 10) employees (Figure 1). So, *the Estonian sample includes relatively small sized firms*. Firms are evenly distributed by size groups in trade and business services, but only 37% of the micro enterprises which were interviewed are in food processing sector. Around 22 % of firms deal with more than one activity, which includes different trades (retail and wholesale) and services (only in 5 cases food production) as a second or third activity. The state of the sector and competition conditions affect the relationships between enterprises and strategies. Depending on external conditions and internal resources, enterprises may choose several fields of activities. When estimating differences between sectors it is important to consider in business

relations also intra-sectoral differences. For example, depending on the kind of service, firms offering business services may have quite different customers, legal regulation and supplier-customer relationships (e.g. in retail and wholesale trade).

Figure 1. Histogram: distribution of firms by number of employees in the sample



The firms surveyed are located in the capital Tallinn and the surrounding Harju county. These accounted for 59% of operating businesses in 2001 compared with only 29% of the total population (on the basis of National Tax Board). The number of enterprises per 1000 inhabitants is relatively high compared with other regions in the country, which means higher competition between firms and opportunities for active relationships between enterprises, and experience of managers. Such an approach will give an opportunity to find a larger number of different business relations and to estimate the importance of trust in these relations.

Table 1. When did the enterprise commence trading?

Sector and size		When did the enterprise commence trading (years)			
		< 1 year	1–2.5	2.5–5.5	> 5.5
Food sector		1	1	12	16
Trade		3	5	8	21
Business services		2	2	10	24
Total		6	8	30	61
	%	5.7	7.6	28.6	58.1

The share of older firms over 5.5 years represent more than half (58%) of the sample. Nearly 42% of firms in the sample commenced their trading less than 5.5 years ago. Of these, only 6 firms have been trading for less than a year and 8 firms for between 1 and 2.5 years (Table 1). 30 firms (29%) are 2.5–5.5 years old. The share of older firms (over 5.5 years) is higher than that of young firms in all sectors and size groups under investigation. One may suppose that business relations in the latter firms are developed and have achieved more a mature character than in the younger firms. This, in turn, allows us to expect that older firms attach greater importance to trust in business relations than younger firms. The distribution of firms by age allows an analysis of the results of the survey mainly in two groups: 1) firms less than 5.5 years old; 2) firms over 5.5 years old.

Status at start and ownership

The majority of enterprises surveyed were newly established (74%) and the rest were based on another existing enterprise (restructured, privatized, bought) (Table 2). The privatized and restructured firms were more often older firms which commenced trading in the period when active privatization took place in Estonia (in 1992–1994). In privatised enterprises the relationships formed during the previous period may be of some importance. However, because changes in economic relations during the transition from a planned economy to a market economy have created an entirely new business environment in Estonia, the old relations may not be a major influence.

Table 2. In which way was the enterprise established?

		0–9 employees		10–49 employees		Total	
Enterprise was:	newly established	36	75.0%	42	73.7%	78	74.3%
	bought	3	6.3%	3	5.3%	6	5.7%
	privatised	5	10.4%			5	4.7%
	restructured from another enterprise	4	8.3%	11	19.3%	15	14.3%
	other			1	1.8%	1	1.0%
Total		48	100.0	57	100.0	105	100.0%

87 (83%) firms were entirely in private Estonian ownership, 8 firms were joint ventures and 10 were in foreign ownership. Foreign ownership prevailed in 2 food processing firms, 9 trade and 7 business services. The impact of foreign ownership may be reflected in the organisation's culture, which depends on national peculiarities of ethical standpoints, traditions or various other differences. This in turn also affects business relations and the importance of trust in making business deals. Joint ventures and firms with foreign ownership were mainly small firms (10–49 employees). Only 3 out of 18 were micro firms.

The role of trust and business partners

There were more firms with partners in the business services sector, and among small and older firms. The participation in capital and know-how was the highest. Participation in management was higher in the business services and trade sectors, and among small and older firms (Table 3).

More than half of the firms in the sample had business partners. 60 firms (57%) in the sample had partners, of which 48 firms (55%) were Estonian and 4 (40%) were under foreign ownership (Table 4). It was mostly older (over 5.5 years) and larger (10–49 employees) firms that worked with partners. By sectors the business services had the largest percentage of partners (76%) while food processing had the least (40%).

The partners had mainly contributed capital (56% of firms) and know-how (44%). Less were involved in management (38%). The small role in contributing technology (4.6% in Estonian firms) is surprising, although one might suppose that partners may be indirectly involved in technology contribution through contributing capital and know-how.

Table 3. The role of partners by firms' groups, % of respondents

Firms' groups	The role of partners					
	no part- ners	in capital	in know- how	in tech- nology	in man- agement	Total
<i>Sector</i>						
food processing	18	12	8	3	7	30
%	40.0	20.3	17.4	60.0	17.5	28.6
trade	18	19	16		15	37
%	40.0	32.2	34.8		37.5	35.2
business services	9	28	22	2	18	38
%	20.0	47.5	47.8	40.0	45.0	36.2
Total	45	59	46	5	40	105
%	100.0	100.0	100.0	100.0	100.0	100.0
<i>Firm size group</i>						
0–9 employees	24	24	19	1	17	48
%	53.3	40.7	41.3	20.0	42.5	45.7
10–49 employees	21	35	27	4	23	57
%	46.7	59.3	58.7	80.0	57.5	54.3
Total	45	59	46	5	40	105
%	100.0	100.0	100.0	100.0	100.0	100.0
<i>Age of firm</i>						
0–5,5 years	24	19	16	2	16	44
%	53.3	32.2	34.8	40.0	40.0	41.9
over 5,5 years	21	40	30	3	24	61
%	46.7	67.8	65.2	60.0	60.0	58.1
Total	45	59	46	5	40	105
%	100	100	100	100	100	100

Entrepreneurs assessed the importance of trust in their relationships with business partners very highly. 86.7% of firms with partners answered that trust is very important and nearly 11.7% that it is important (Table 5). In accordance with the sample estimation, the importance of trust in business relationships was more valuable in the firms where partners were contributing capital, but also in small and older firms rather than micro and younger firms. By sectors, the importance of trust has been estimated as more important in the business services and trade sectors when compared with the food-processing sector (fewer partners).

Table 4. The importance of trust depending on the role of business partners involved in the firm assessed by managers on the scale from 1 = very important to 5 = of no importance.

The role of partners	The importance of trust							
	Very important (1)		Important (2)		Average importance(3)		Total	
	No.	%	No.	%	No.	%	No.	%
Contribute capital	51	85.0	7	11.7	1	1.7	59	98.3
Contribute know-how	41	68.3	5	8.3			46	76.7
Contribute technology	4	6.7	1	1.7			5	8.3
Involved in management	33	55.0	6	10.0	1	1.7	40	66.7
Total	52	86.7	7	11.7	1	1.6	60	100.0

Note: % of firms with partners

Table 5. The importance of trust in the relationship with business partners assessed by managers on the scale from 1 = very important to 5 = of no importance

	Very important (1)		Important (2)		Average importance (3)		Total	
<i>Firm size group</i>		%		%		%		%
0–9 employees	20	33.3	4	0.7	0	0	24	40.0
10–49 employees	32	53.3	3	0.5	1	1.7	36	60.0
<i>Age of firm</i>								
Below 5.5 years	16	26.7	4	0.7	0	0	20	33.3
Over 5.5 years	36	60.0	3	0.5	1	1.7	40	66.7
<i>Sector</i>								
Food	11	18.3	1	0.2			12	20.0
Trade	18	26.7	3	0.5			21	31.7
Business services	25	41.7	3	0.5	1	1.7	29	48.3
Total	52	86.7	7	11.7	1	1.7	60	100.0

Note: % of firms with partners

Business development in 2001 and 2002

Most of the firms in the sample had kept employment levels stable. Comparing the number of employees today with 12 months ago, it was higher in 13% of firms, about the same in around two third of firms and lower in 18% of firms. Employment increased more frequently in young firms, food processing and trade sectors. Stable employment levels was a bit more characteristic for micro enterprises (72%), older firms (75%) and in business services (78%). By ownership groups, local firms were more stable (74%) (Table 6).

More than half of the firms (68%) increased their sales in 2001 compared with 2000. Increasing sales were more often observed in small and older firms and in business services compared with other groups of enterprises. A stable sales level, like a stable number of employees, was more characteristic for micro enterprises. Changes in the level of sales and turnover provide possible grounds for the managers' satisfaction with the performance of their business.

Tabel 6. Change in the level of sales and employment, % of respondents

	Higher		About the same		Lower		Total	
	No	%	No	%	No	%	No	%
<i>Level of sales in 2001 compared with 2000</i>								
Firm size group								
0–9 employees	22	50.0	13	29.5	9	20.5	44	100.0
10–49 employees	37	69.8	11	20.8	5	9.4	53	100.0
Age of firm								
0–5.5 years	21	58.3	9	25.0	6	16.7	36	100.0
Over 5.5 years	38	62.3	15	24.6	8	13.1	61	100.0
Sector								
Food processing	18	62.1	8	27.6	3	10.3	29	100.0
Trade	16	48.5	9	27.3	8	24.2	33	100.0
Business services	25	71.4	7	20.0	3	8.6	35	100.0
Total	59	60.8	24	24.7	14	14.4	97	100.0
<i>No of employees today compared with 12 months ago</i>								
Firm size group								
0–9 employees	6	13.0	33	71.7	7	15.2	46	100.0
10–49 employees	7	12.7	37	67.3	11	20.0	55	100.0
Age of firm								
0–5.5 years	6	14.6	25	61.0	10	24.4	41	100.0
Over 5.5 years	7	11.7	45	75.0	8	13.3	60	100.0
Sector								
Food processing	4	13.8	19	65.5	6	20.7	29	100.0
Trade	5	13.9	23	63.9	8	22.2	36	100.0
Business services	4	11.1	28	77.8	4	11.1	36	100.0
Total	13	12.9	70	69.3	18	17.8	101	100.0

Note: 8 enterprises from the sample have operated less than two years and could not answer about the change in the level of sales; change in employment is not considered in 4 firms.

The firms were more satisfied with sales growth and personal goals than profits. If the answers are considered together, where entrepreneurs were satisfied or partly satisfied with business development, then the highest satisfaction was expressed by entrepreneurs in the level of sales. 87% of respondents (incl. 91% of firms with 10–49 employees) were satisfied with the level of sales in 2001. This was followed by satisfaction with personal goals (83.5%). But entrepreneurs were less satisfied with the level of profits. Nearly 21% of them were entirely satisfied and 53% were partly satisfied, but 27% of them were not satisfied with the level of profits (Table 7).

Table 7. The extent of satisfaction with the performance of the business in 2001

	Level of sales		Level of profits		Personal goals	
		%		%		%
Not satisfied	13	12.7	27	26.5	16	16.5
Partly satisfied	56	54.9	54	52.9	55	56.7
Satisfied	33	32.4	21	20.6	26	26.8
Total	102	100.0	102	100.0	97	100.0

It is logical that managers of enterprises with increasing sales were more satisfied with the level of sales, profits and the achievement of personal aims. In firms with an increasing number of employees, satisfaction with sales and profits was higher than average (Table 8). Among managers of firms with a stable or decreasing number of employees, partial satisfaction was observed more often. Dissatisfaction was also mentioned more often in these firms. Although the number of employees was related to the sales possibilities of the firm and changes in turnover, a decrease in the number of employees may be due to increased productivity, which is a positive indicator for a firm and should thus not cause reduced satisfaction. Nevertheless, managers were more satisfied with business performance in those firms where employment remained stable. Satisfaction with personal goals was a little higher in firms with decreasing employment.

Table 8. The extent of satisfaction with the performance of the business in 2001 depending on changes in the level of sales and number of employees

The extent of satisfaction	Level of sales in 2001 compared with 2000							
	Higher		About the same		Lower		Total	
	No	%	No	%	No	%	No	%
Level of sales								
Not satisfied	2	16.7	6	50.0	4	33.3	12	12.4
Partly satisfied	29	54.7	15	28.3	9	17.0	53	54.6
Satisfied	28	87.5	3	9.4	1	3.1	32	33.0
Total	59		24		14		97	100.0
Profit								
Not satisfied	8	34.8	9	39.1	6	26.1	23	23.7
Partly satisfied	35	64.8	12	22.2	7	13.0	54	55.7
Satisfied	16	80.0	3	15.0	1	5.0	20	20.6
Total	59		24		14		97	100.0
Personal goals								
Not satisfied	4	26.7	7	46.7	4	26.7	15	16.3
Partly satisfied	32	58.2	15	27.8	8	15.5	55	59.8
Satisfied	20	90.9	1	4.5	1	4.5	22	23.9
Total	56		23		13		92	100.0

Table 8 (continued). The extent of satisfaction with the performance of the business in 2001 depending on changes in the level of sales and number of employees

	Number of employees 12 months ago							
	Higher		About the same		Lower		Total	
	No	%	No	%	No	%	No	%
Level of sales								
Not satisfied	4	30.8	8	61.5	1	7.7	13	12.8
Partly satisfied	3	5.5	40	72.7	12	21.8	55	54.5
Satisfied	6	18.2	22	66.7	5	15.2	33	32.7
Total	13		70		18		101	100.0
Profit								
Not satisfied	4	14.8	17	63.0	6	22.2	27	26.7
Partly satisfied	5	9.4	39	73.4	9	17.0	53	52.5
Satisfied	4	19.0	14	66.7	3	14.3	21	20.8
Total	13		70		18		101	
Personal goals								
Not satisfied	3	20.0	8	53.3	4	26.7	15	15.6
Partly satisfied	9	16.4	40	72.7	6	10.9	55	57.3
Satisfied	1	3.8	18	69.2	7	26.9	26	27.1
Total	13	13.5	66	68.8	17	17.7	96	100

Note: young enterprises, which could not determine changes in sales and employees, are not present.

It is interesting that the satisfaction with the level of sales and profits increased, but satisfaction with personal goals decreased, with the age of the firms (Table 9). These differences are rather small and may partially be due to the smallness of the sample. A closer analysis of managers' attitude towards trust reveals that managers of older firms attach much more importance to trust in their relationships with partners, as well as with customers and suppliers, when giving credits is involved. Older firms also appreciated trust more when it was necessary to decide who could be asked for help or how much to trust one's own employees. In making such decisions they have an advantage of wider and long-term experience of business contacts.

However, if we look at the problems which were most often mentioned as hindering the firm's growth by those managers who were not satisfied with the achievement of their personal goals, we can see that these include capital, the macroeconomic environment and legal regulation. These are followed by personnel, buildings, equipment etc. (Table 9). The same problems are most often mentioned by the managers of older firms. Therefore, reasons for the dissatisfaction of managers should be sought among the difficulties of solving these problems, which, in turn, may be, at least partly, connected with issues of institutional trust (e.g. legislation). When managers were asked about the factors influencing the satisfaction of personal goals, they named: liberal economic policy, strong competition, hard working conditions as the result of a changing political environment, the limited size of the national market, difficulties in finding foreign markets etc. These answers are all connected with problems in the business environment. More detailed analysis on the external circumstances that encourage trust and its development in individuals over time is, in turn, required. The small number of enterprises in the sample prevents a more thorough analysis.

Table 9. The extent of satisfaction with the performance of the business in 2001 depending on the age of the firm

	< 1 year (in %)	1–2.5 years (in %)	2.5–5.5 years (in %)	>5.5 years (in %)
Level of sales				
Not satisfied	33.3	12.5	13.3	11.5
Partly satisfied	66.7	62.5	53.3	54.1
Satisfied		25	33.3	34.4
Total	100	100	100	100
Level of profits				
Not satisfied	100	50	30.0	18.0
Partly satisfied		37.5	50.0	59.0
Satisfied		12.5	20.0	23.0
Total	100	100	100.0	100
Personal goals				
Not satisfied	33.3	14.3	13.8	17.2
Partly satisfied		42.9	65.5	56.9
Satisfied	66.7	42.9	20.7	25.9
Total	100	100	100	100

Profile of owner/manager/respondent

Sex and age

The majority of entrepreneurs in the sample were men (70.5%). The sex of entrepreneurs is rather evenly distributed by firms' size groups (Table 10). Women are better represented in firms with private Estonian ownership and in food production firms (43% compared with average 29.5%), but less so in the business service sector (18%).

With regards to age, 36% of entrepreneurs were in the 30–39 age group, 29.5% in the 40–49 age group, and 19% in the 50–59 age group (Table 11). The proportion of those younger than 30 years and older than 60 years was similar – 7.6%. Younger entrepreneurs were more frequently represented in the trade and business services sector and in micro and younger firms.

Table 10. Distribution of entrepreneurs by sector, ownership, firms' size group and involvement of partners.

	Groups of firms		Women	Men
Sector	Food processing		13	17
		%	43.3%	56.7%
	Trade		11	26
		%	29.7%	70.3%
	Business services		7	31
		%	18.4%	81.6%
Ownership	Entirely private (Estonian)		28	59
		%	32.2%	67.8%
	Joint venture		1	7
		%	12.5%	87.5%
	Foreign ownership		2	8
		%	20.0%	80.0%
Firms' size group	0–9 employees		14	34
		%	29.2%	70.8%
	10–49 employees		17	40
		%	29.8%	70.2%
Partners	No partners		15	30
	Partners		16	44
Total			31	74
			29.5	70.5

Table 11. Age of entrepreneurs by sector, firms' age and size

	20–29	30–39	40–49	50–59	Over 60	Total
Food processing	2	4	9	12	3	30
	6.7%	13.3%	30.0%	40.0%	10.0%	100.0%
Trade	3	20	8	4	2	37
	8.1%	54.1%	21.6%	10.8%	5.4%	100.0%
Business services	3	14	14	4	3	38
	7.9%	36.8%	36.8%	10.5%	7.9%	100.0%
0–9 employees	2	20	17	7	2	48
	4.2%	41.7%	35.4%	14.6%	4.2%	100.0%
10–49 employees	6	18	14	13	6	57
	10.5%	31.6%	24.6%	22.8%	10.5%	100.0%
0–5.5 years	7	21	7	8	1	44
	15.9%	47.7%	15.9%	18.2%	2.3%	100.0%
over 5.5 years	1	17	24	12	7	61
	1.6%	27.9%	39.3%	19.7%	11.5%	100.0%
Total	8	38	31	20	8	105
	7.6%	36.2%	29.5%	19.0%	7.6%	100.0%

Education

The Entrepreneurs interviewed were highly educated. Two thirds of the entrepreneurs had a university level education. Nearly 28% of the entrepreneurs had a secondary vocational education. The rest had a secondary education. None of the managers had a primary education only (Table 12). However, the larger portion of those with a university level education were in the business services, in older firms and those firms with 10–49 employees.

Professional background

The experience in management was relatively high among the managers interviewed. Nearly 64% of the entrepreneurs in the sample had previously worked in private businesses. Only 23.8% of them had been an owner in the past (Table 13). 34% of entrepreneurs had moved from the public (state) sector to the private sector. Two thirds of the entrepreneurs had previous experience in management. The number of experienced managers was higher than average among the older enterprises and in the business services. When these managers were asked about the sources of capital, they answered that they had not received capital from or lent money to former colleagues. This means that relationships with former colleagues do not help firms to find or lend capital. However, if we look at different kinds of co-operation, managers mentioned colleagues from the same industry as the most important source of information about markets. Of course, this does not mean that these are colleagues from the former place of employment.

Table 12. Level of education

	<i>Secondary school</i>	<i>Secondary vocational school</i>	<i>University level</i>	<i>Total</i>
Food processing	2	10	18	30
	6.7%	33.3%	60.0%	100.0%
Trade	4	13	20	37
	10.8%	35.1%	54.1%	100.0%
Business services		6	32	38
		15.8%	84.2%	100.0%
0–9 employees	4	19	25	48
	8.3%	39.6%	52.1%	100.0%
10–49 employees	2	10	45	57
	3.5%	17.5%	78.9%	100.0%
0–5.5 years	5	12	27	44
	11.4%	27.3%	61.4%	100.0%
over 5.5 years	1	17	43	61
	1.6%	27.9%	70.5%	100.0%
Total	6	29	70	105
	5.7	27.6	66.7	100.0

Table 13. Previous work experience in management and the type of organisation

<i>Where did you worked previously?</i>	<i>Count</i>	<i>%</i>
State production sphere	11	10.5
State non-production sphere	25	23.8
Private business in which you were not an owner	44	41.9
Private business of which were an owner	23	21.9
Education	1	1.0
Unemployed	1	1.0
Total	105	100.0
<i>Experience in management</i>		
Previous experience in management	72	68.6
No experience in management	33	31.4
<i>If yes, in what type of organisation?</i>		
State enterprise	19	18.1
State institution	16	15.2
Private enterprise	36	34.3
Non-government organisation	1	1.0
Total	105	100.0

Characteristics of the market served

Geographical distribution of market presence

The majority of firms served local markets and received around 80% of their turnover (median) from local markets. Almost all the enterprises surveyed (except 1) served the local markets in which they were located. Nearly two thirds of the firms (64%) served the national market outside the parish or county. 24% of firms served foreign markets in NIS, Baltic states and CEE. 9.5% served in foreign markets in developed Western countries and 2 enterprises had markets in other countries. Foreign markets were served by joint ventures and enterprises with foreign ownership, but also 25 (28.7%) enterprises with Estonian owners. By sector, enterprises in food processing sector received the most income from local markets (95% median). This was followed by the trade (80%) and business service (75%) sectors. Foreign markets were served mainly by firms from the business service sector (60% of those serving foreign markets). Thus, the distribution of markets shows that an analysis of factors affecting business relations should consider first and foremost the external environmental conditions in the local and national markets. This applies to all the enterprises in the sample. The conditions of foreign markets may have more of an impact on the business services sector.

Changes in turnover in 2001 indicated an improving business environment in the local and national markets. In most cases, turnover remained stable in local markets (for 77.2% of those serving local markets) and also in other markets (Table 14). Turnover increased in 13.9% of the firms in the local, and in 8.9% in the national, markets, but decreased more often among those firms operating in foreign markets (e.g. it increased for 1%, but decreased for 5.7% of firms). This may indicate the improvement of the business environment in local and national markets (e.g. growth in purchasing power), but also difficulties in selling in foreign markets for firms, in this sample at least. In local and national markets, trade enterprises were more stable (83% of all trade enterprises). Growth was more frequent in the enterprises from food processing (16.7%) and the business service (15.8%) sectors. The stability of turnover indicates the stability of the business environment, as well as a level of competitiveness between enterprises which is too low to promote growth. The last example suits best trade firms, where, in recent years, competition has grown quickly as a result of the establishment of large chains of supermarkets in the Estonian market. The supply of goods has been growing more quickly than the population's purchasing power. Under the conditions of tough competition steady and trustful relationships with customers and suppliers may help enterprises to succeed.

Table 14. Changes of turnover by markets, % of respondents

Location of markets	No changes		Increased		Decreased		Total	
	No	%	No	%	No	%	No	%
Oblast/region in which the business is located	78	77.2	14	13.9	9	8.9	101	100.0
National market outside oblast/region	44	67.7	11	16.9	10	15.4	65	100.0
Foreign markets in NIS, Baltic states, CEE	18	72.0	1	4.0	6	24.0	25	100.0
Foreign markets in Western Europe and Western highly developed countries	7	70.0	1	10.0	2	20.0	10	100.0
Foreign markets in other countries		0.0	1	50.0	1	50.0	2	100.0

Note: % of those serving certain markets

Although trust in partners was regarded as important by the overwhelming majority of the enterprises, the proportion of respondents dissatisfied with the achievement of the enterprises and personal goals was higher among those who operate in local or national markets. Reasons might be found in the market conditions (including trust relations; market size etc.) and in the ability to respond to market changes (e.g. resources, skills and experience).

The role of the shadow economy

The role of the shadow economy is declining. When entrepreneurs were asked to estimate the share of business income which comes from shadow operations, nearly 44% of them answered zero, and 45% answered that this share might be below 25%. Often they said that this might be 5–10%. However, 10 (9.5%) entrepreneurs thought that in some branches of the economy the share of shadow economy could be even higher than 25%.

The managers interviewed in the case studies referred to the growth in the formal sector and the declining share of the shadow economy in Estonia as progressing alongside growing competition, improving legislation (incl. those connected with social protection systems – health care, pension) and the growing awareness of the population. However, the high unemployment rate in Estonia encourages a shadow economy (e.g. in personal services and transport).

The proportion of the informal sector was estimated at 20–30% in the early period of transition (Tihemets, 1996). The heavy burden of payroll tax, especially on small enterprises, has favoured the formation of the informal sector – the employer and the employee agree not to register employment and thus evade taxes. One of the reasons for such a situation, the low cost of participation in the informal market in the form of not receiving the relevant pension or some other benefit, has already been mentioned. Amendments to legislation have played an important role in changing this: the payroll tax has been personalized since 1999, which directly influences the future pension of the employees. This has increased the interest of employees in receiving legal pay. Since the Pension Act came into force (2001) people's interest in working in the formal sector has increased. Currently, the Statistical Office estimates that the proportion of the shadow economy is about 10% of GDP. The shadow economy still plays a noteworthy role in the construction, transportation and personal services. The situation in the labour market contributes to this. The following factors might be mentioned: a scarcity of jobs in the legal sector; a high unemployment rate, including a high share of long-term unemployed and the large proportion of the population which is inactive. Thus, the legal environment of the labour market is not completely regulated.

According to the entrepreneurs (78% of respondents) the main reason for operating in the shadow economy is to avoid or reduce taxes (social tax, income tax, VAT) (Table 15). This refers to the high tax burden for enterprises, especially high social tax, where employers are liable to pay the whole of the social tax, which is 33% of total payroll expenses (i.e. salary plus the value of any non-monetary benefits offered to employees). This represents a significant additional labour cost for employers, particularly on new and small (10–49 employees) firms. This reason was more frequently mentioned also by firms from the food processing sector. Another reason for operating in the shadow economy may be to avoid government regulations (17% of respondents). An explanation of this might be the need to improve technological conditions at enterprises in connection with applying EU requirements in Estonia. Evasion of regulations was more often mentioned by younger entrepreneurs, those in small firms and in the food industry. Females mentioned mainly these three reasons, while males also referred to some other answers.

Table 15. The opinion of entrepreneurs as an expert to the main reasons for those who are operating in shadow economy, col % of respondents

Reasons for operating in shadow economy	Sector			Group of employees number		Group of enterprise age, years		Total
	food	trade	services	0–9	10–49	0–5.5	over 5.5	
Avoid or reduce taxes	18	18	16	20	32	23	29	52
%	60.0	48.6	42.1	41.7	56.1	52.3	47.5	49.5
Avoid or reduce obligatory social contributions	12	8	10	11	19	15	15	30
%	40.0	21.6	26.3	22.9	33.3	34.1	24.6	28.6
Avoid attention of criminals	1			1		1		1
%	3.3			2.1		2.3		1.0
Avoid local government regulations	12	6		5	13	12	6	18
%	40.0	16.2		10.4	22.8	27.3	9.8	17.1
Avoid complicated licensing and/or registration procedures	4	1		1	4	3	2	5
%	13.3	2.7		2.1	7.0	6.8	3.3	4.8
Other	2	1		2	1	3		3
%	6.7	2.7		4.2	1.8	6.8		2.9

Below an attempt is made to analyse trust relationships (depending on the importance of trust) with business partners, customers and suppliers in comparison with the entrepreneurs' estimate of the size of the shadow economy and its peculiarities. The analysis revealed that, on the whole, trust was regarded as important by the entrepreneurs who considered the share of shadow economy to be low (either 0 or below 25%) (Table 16). However, trust towards business partners and suppliers was even more important for entrepreneurs who admitted the existence of shadow economy (i.e. below 25%). Their higher appreciation of trust becomes especially vivid if we look at the scale of trust (in scale 1–5). Here they selected the answer 'very important' about 10% more often than the entrepreneurs in whose opinion the role of shadow economy was zero. Trust was considered more important by those who mentioned tax evasion as the reason for the existence of shadow economy. In general, however, the differences in the estimates of the subjects considered (business partners, customers, suppliers) were small.

Table 16. The relationship between trust and the size and characteristics of the shadow economy, % of respondents

Why, % of respondents		Importance of trust		
		With business partners	In offering credit to customers	In offering credit by suppliers
Reasons for operating in shadow economy				
Avoid or reduce taxes		52	35	34
	Col%	49.5	49.3	50.7
Avoid or reduce obligatory social contributions	Cases	30	18	19
	Col%	28.6	25.4	28.4
Avoid attention of criminals	Cases	1	1	1
	Col%	1.0	1.4	1.5
Avoid local government regulations	Cases	18	13	15
	Col%	17.1	18.3	22.4
Avoid complicated licensing and/or registration procedures	Cases	5	4	4
	Col%	4.8	5.6	6.0
Other	Cases	3	3	2
	Col%	2.9	4.2	3.0
Cases		105	71	67
Estimating the share of business income from shadow economy				
0	Count	46	31	27
	Row %	100	100	100
	Col %	43.8	43.7	40.3
Below 25%	Count	47	31	31
	Row %	100	100	100
	Col %	44.8	43.7	46.3
Below 50%	Count	9	7	7
	Row %	100	100	100
	Col %	8.6	9.9	10.4
Below 75%	Count	1	1	
	Row %	100	100	
	Col %	1.0	1.4	
Count		105	71	67

Customer base

The main types of customer that enterprises serve are private firms (for 70.5% of respondents), final consumers (53%), state owned firms (39%) and distributors/wholesalers (35%) (Table 17). The most frequently served customers for food processing enterprises are distributors/wholesalers and private firms. For trade they are final consumers and private firms and for business services they are private firms and public sector institutions. The average number of clients is 240 per firm (median). The number of customers served depends on the type of firm. For that reason trade firms have the highest number of customers (median 4000, final consumers), which is followed by firms of business services (100) and food processing sector (65). When the companies were sorted according to their size and age the differences were smaller. Still, small enterprises (10–49 employees) more often rendered services to wholesale enterprises (42% of small enterprises) and state-owned enterprises (44%) than micro enterprises did (27% and 33% respectively). Younger enterprises served more often final consumers (64%) and older ones, state-owned enterprises (44%). This allows us to conclude that older small enterprises have long-term relationships, especially with customers in the public sector. This should be revealed by the proportion of regular customers among the total number of customers.

Table 17. Types of customers served by sectors, % of respondents

		Sector			Total
		Food processing	Trade	Business services	
Final consumers		12	28	16	56
	%	40.0%	75.7%	42.1%	53.3%
Distributor/wholesalers		19	17	1	37
	%	63.3%	45.9%	2.6%	35.2%
Retail outlets		2	1		3
	%	6.7%	2.7%		2.9%
Private firms		14	23	37	74
	%	46.7%	62.2%	97.4%	70.5%
State owned firms		5	10	26	41
	%	16.7%	27.0%	68.4%	39.0%
Other		6	1	2	9
	%	20.0%	2.7%	5.3%	8.6%

The share of regular customers in firms surveyed was estimated at 75% (median). Regular customers made up the largest percentage in the food processing sector. Over two thirds of these firms (73.3%) had 76–100% regular customers among the total number of customers. In the trade sector the share of such enterprises was 43% and in business services, 22%. This indicates the differences between the sectors. For example, it is difficult to maintain long-term relationships with final consumers (relatively anonymous relationships). The majority of enterprises among those with regular customers considered the existing business relationships important. A high share of regular clients decreases risk in the market and makes business relations trustworthy. This, in turn, also influences strategies for contracting with customers and suppliers. However, our survey shows that the enterprises with a high share of regular customers more often used written contracts (nearly 78% of the enterprises). However, the share of bank trans-

fers is smaller (86%) than in the case of enterprises with a smaller proportion of regular customers (73% and 100% respectively). Still, the differences between these groups are not great (Table 18). These figures give reason to assume that the relationships guaranteed by written contracts are stable. The difference between payment terms is greater; the terms are longer in the case of firms where regular customers were more important.

Table 18. The types of agreements and the share of regular customers

Type of agreements with customers		The share of regular customers			Total
		to 50%	51–75%	76–100%	
No agreements with customers	Count	7	5	6	18
	Row %	38.9	27.8	33.3	100.0
	Col %	18.9	26.3	12.2	17.1
Oral agreements with customers	Count	21	11	25	57
	Row %	36.8	19.3	43.9	100.0
	Col %	56.8	57.9	51.0	54.3
Written agreements with customers	Count	30	6	42	78
	Row %	38.5	7.7	53.8	100.0
	Col %	85.7	75.0	67.7	74.3

Supplier base

There were, on average, 7 suppliers per firm (median, 27 by mean). *On average 90% of the suppliers were used regularly by enterprises.* This means that the enterprises had tried to establish regular and long-term relationships with their suppliers. Obviously the business environment favours such behaviour. The choice of contract type did not affect the proportion of regular suppliers significantly, as, in both cases written contracts predominated (Table 19). Still, in about a third of the cases oral agreements were also used

Table 19. The types of agreements and the share of regular suppliers

Type of agreement		The share of regular suppliers			Total
		to 50%	51–75%	76–100%	
Oral agreements with suppliers	Count	2	2	29	33
	Row %	6.1	6.1	87.9	100.0
	Col %	5.7	25.0	46.8	31.4
Written agreements with suppliers	Count	8	8	50	66
	Row %	12.1	12.1	75.8	100.0
	Col %	22.9	100.0	80.6	62.9

Note: 6 firms do not have suppliers

The role of existing business relationships was regarded as more important by the enterprises that have a smaller proportion of regular customers but a larger proportion of regular suppliers (Table 20).

Table 20. The role of existing business relations and regular customers

		Share of regular customer			Total	Share of regular suppliers			Total
		to 50%	51–75%	76–100%		to 50%	51–75%	76–100%	
As important as the business deal	Count	30	14	37	81	25	5	51	81
	Row %	37.0%	17.3%	45.7%	100.0%	30.9%	6.2%	63.0%	100.0%
	Col %	81.1%	73.7%	75.5%	77.1%	71.4%	62.5%	82.3%	77.1%
More important than the business deal	Count	4	1	2	7	6		1	7
	Row %	57.1%	14.3%	28.6%	100.0%	85.7%		14.3%	100.0%
	Col %	10.8%	5.3%	4.1%	6.7%	17.1%		1.6%	6.7%
Less important than the business deal	Count	3	4	10	17	4	3	10	17
	Row %	17.6%	23.5%	58.8%	100.0%	23.5%	17.6%	58.8%	100.0%
	Col %	8.1%	21.1%	20.4%	16.2%	11.4%	37.5%	16.1%	16.2%

Sources and channels for marketing information

Almost all firms used a variety of methods to increase the sales of their products/services and to gain customers. The most frequently used methods were recommendations from customers and suppliers (for 80% of respondents), advertising in mass media (48.6%), word of mouth via family & friends (35%). These were followed by exhibitions (25%) and brochures (22%) (Table 21). 14 entrepreneurs (13%) answered that, in addition to other methods, they used direct marketing/direct contacts with customers via telephone, e-mail, meetings etc. Word of mouth via family and friends and recommendations from customers and suppliers are more frequently used by enterprises from business services (53% and 92% respectively) and advertising in the mass media and exhibitions were more often employed by trade enterprises (59.5 and 35%). More than a third of enterprises from the food processing sector used four main methods of advertising (recommendations, word of mouth, mass media and exhibitions). The size and age of the enterprise had less of an influence on the types of methods employed. However, younger and micro enterprises used recommendations from customers and suppliers (83 and 89% of enterprises) and word of mouth via family and friends (35 and 38.5% of enterprises) more often. This is the cheapest way for micro firms to increase their sales. Small and older enterprises used more advertising via mass media (49 and 53%), exhibitions (33% both) and brochures (23% and 26%). This is logical, because using these information channels requires more resources, experience and contacts.

Telephone catalogues, web pages and specialized advertising newspapers (*Kulдне Börs, Soov*) were mentioned in case studies as the most frequently used (the cheapest) sources for advertising today for smaller firms.

Table 21. Methods enterprises are using to increase the sales of their products/services and/or to gain customers, Col% of respondents

	Food processing	Trade	Business services	Total used	0–9	10–49	0–5.5	>5.5
None	1			1	1		1	
Col%	3.3			1.0	2.1		1.6	
word of mouth via family & friends	12	5	20	37	17	20	17	20
Col%	40.0	13.5	52.6	35.2	35.4	35.1	38.6	32.8
recommendations from customers and suppliers	22	27	35	84	40	44	39	45
Col%	73.3	73.0	92.1	80.0	83.3	77.2	88.6	73.8
advertising in mass media	10	22	19	51	21	30	21	30
Col%	33.3	59.5	50.0	48.6	43.8	52.6	47.7	49.2
brochures, flyers, etc.	7	7	9	23	8	15	9	14
Col%	23.3	18.9	23.7	21.9	16.7	26.3	20.5	23.0
Exhibitions	10	13	3	26	7	19	6	20
Col%	33.3	35.1	7.9	24.8	14.6	33.3	13.6	32.8
Other: direct marketing/ contacts	5	6	3	14	3	11	7	7
Col%	16.7	16.2	7.9	13.3	6.3	19.3	15.9	11.5

The main sources of information about what is happening in domestic markets were considered by entrepreneurs to be: existing customers and suppliers (62%), colleagues from businesses of the same industry (68%), general press/mass media (52%), but also employees (29.5%) and trade journals (26%) (Table 22). An analysis shows that the size and age of the firms influenced the managers' use of sources of information less than the sector in which the enterprise operated. For that reason, though it is possible to find some differences when the firms are organised by age and size, these are rather small. However, for enterprises in the food processing sector existing customers and suppliers were a more important source of information (77% of food processing enterprises) than for colleagues from other businesses. Food processing enterprises also got information informally from other businesses more often. This may be due to the relatively smaller experience of co-operation among food processors (with fewer partners and less instances of memberships in business associations: e.g. 27.5% of enterprises compared to 50% among the business services firms). Food processing enterprises attach less importance to trust in their relations with business partners or customers and suppliers than the other sectors. This might also explain the use of informal information channels.

Table 22. How do you obtain information about what is happening in domestic and foreign markets?

Source of information	In domestic markets		In foreign markets	
	Count	%	Count	%
from existing customers and suppliers	65	61.9	17	16.2
from employees	31	29.5	8	7.6
informally from other businesses	15	14.3	1	1.0
colleagues from the same industry	71	67.6	17	16.2
from trade journals/ literature	27	25.7	4	3.8
from the general press/media	55	52.4	15	14.3
active market research	9	8.6	2	1.9
from a consultant, business support agency	3	2.9	0	0.0
from business associations, chambers of commerce	5	4.8	2	1.9
from trade fairs/exhibitions	7	6.7	1	1.0
other (please specify)	6	5.7	2	1.9
Total	105	100.0	105	100.0

The main sources of information for enterprises in the business services sector were colleagues from other businesses (84%), the press/media (66%, compared to average of 52.4%) and employees (34%). This may be explained by the fact that service firms consider trust towards their partners more important than other firms (65.8% of the service firms said that trust in business partners was 'very important', whereas the average was 49.5%). Service firms also considered their existing business relationships more important than the firms of the other sectors. To a certain extent, these evaluations may be due to the greater internationalisation of service firms (or foreign interest in the business and a higher share of exports). Trade firms considered relationships with their customers more important (88% against the average of 78.9%). Trust in suppliers (i.e. in crediting) was important for all sectors (irrespective of the fact that in the services sector the role of suppliers is relatively small).

Small enterprises (10–49 employees) more often obtained information from existing customers and colleagues. Small enterprises also attached relatively more importance to trust in business partners and in their existing business relationships with their customers and suppliers. Although, in general, market research was low among the information sources, it was more often used by small, older and trade firms. Toughening competition in trade is increasing the importance of market research by enterprises. Micro firms can use this form of obtaining information less often as it is expensive. Older enterprises (over 5.5 years) regarded trust in all the areas considered here, as well as in the role of existing business relations, as important.

Consultants, business support agencies, business associations and even trade fairs are less used as a source of information, although a number of entrepreneurs interviewed belonged to different associations and unions. Active market research was also used in only a few cases (9%). This requires more resources, which makes it financially difficult for micro and small businesses to carry it out or to order it from market-research centres.

The main sources of information about what is happening in foreign markets are: existing customers and suppliers, colleagues from businesses of the same industry (both 16.2%), general press/mass media (14.3%) and employees (7.6%). These relatively lower percentages in the use of information sources are due to the smaller number of enterprises interested in information on foreign markets. As mentioned above, the enterprises in the sample got the bulk of their income (80%) from the domestic market. Information on foreign markets was more often sought by business services and trade enterprises'. The proportion of businesses with foreign interests was higher among these sectors.

Obtaining information was cited as the most important form of co-operation by entrepreneurs. Although the role of business associations as a source of information had been previously regarded as negligible, let us have a look at how membership in associations affects the finding of information. The analysis shows that only 10% of the members received information on markets through business associations (Table 23). On the other hand, membership in a business association may foster co-operation with colleagues from the same industry. For example, enterprises from the business services sector (where membership of associations is the highest – 50% of the enterprises are members) and members of business associations referred to the colleagues in the same industry more often (77.5% of the members; 84% of enterprises in the business services sector). Those who were not members of business associations referred more often to informal information sources, as in the case of the food-processing sector (which had a low percentage of members).

Table 23. Sources of information and membership of one or more business association, col % of members/non-members

Sources of information	Information about domestic markets				Information about foreign markets		
		Membership		Total	Membership		Total
		no	yes		no	yes	
existing customers, suppliers	Cases	39	26	65	7	10	17
	Row%	60	40	100	41.2	58.8	100.0
	Col%	60	65	61.9	10.8	25.0	16.2
employees	Cases	17	14	31	3	5	8
	Row%	54.8	45.2	100.0	37.5	62.5	100.0
	Col%	26.2	35.0	29.5	4.6	12.5	7.6
informally other businesses	Cases	12	3	15	1		1
	Row%	80.0	20.0	100.0	100.0		100.0
	Col%	18.5	7.5	14.3	1.5		1.0
colleagues in same industry	Cases	40	31	71	6	11	17
	Row%	56.3	43.7	100.0	35.3	64.7	100.0
	Col%	61.5	77.5	67.6	9.2	27.5	16.2

Table 23 (continued). Sources of information and membership of one or more business association, col % of members/non-members

Sources of information	Information about domestic markets				Information about foreign markets		
		Membership		Total	Membership		Total
		no	yes		no	yes	
trade journals/literature	Cases	19	8	27	2	2	4
	Row%	70.4	29.6	100.0	50.0	50.0	100.0
	Col%	29.2	20.0	25.7	3.1	5.0	3.8
general press/media	Cases	37	18	55	6	9	15
	Row%	67.3	32.7	100.0	40.0	60.0	100.0
	Col%	56.9	45.0	52.4	9.2	22.5	14.3
active market research	Cases	5	4	9	1	1	2
	Row%	55.6	44.4	100.0	50.0	50.0	100.0
	Col%	7.7	10.0	8.6	1.5	2.5	1.9
consultant, business support agency	Cases	2	1	3			
	Row%	66.7	33.3	100.0			
	Col%	3.1	2.5	2.9			
business associations, chambers of commerce	Cases	1	4	5	1	1	2
	Row%	20.0	80.0	100.0	50.0	50.0	100.0
	Col%	1.5	10.0	4.8	1.5	2.5	1.9
trade fairs/exhibitions	Cases	4	3	7		1	1
	Row%	57.1	42.9	100.0		100.0	100.0
	Col%	6.2	7.5	6.7		2.5	1.0
other sources	Cases	4	2	6		2	2
	Row%	66.7	33.3	100.0		100.0	100.0
	Col%	6.2	5.0	5.7		5.0	1.9
Cases		65	40	105	65	40	105
Row Response %		185.7	114.3	300.0	185.7	114.3	300.0
Col Response %		300	300	300	300.0	300.0	300.0

Customer-supplier relationships and the role of trust

Decision criteria and preparing new business deals

When entrepreneurs prepare a new business deal there are a number of aspects which are relevant and most important to their decision making: the experience of their firm in this kind of deal (40% of all enterprises), a good business plan (38.5%), the expected profit (38.1%) and

guarantees for failure of delivery or payment (37.1%) (Table 24). The answers “also important” can be ranked in the following way: expected profit following by guarantees for failure of delivery or payment, and recommendations from regular commercial partners.

Table 24. If you prepare a new business deal what aspects are relevant for your decision making?

Factors	3=Most important	2=Also important	1=Not important
expected profit	38.1	61.0	1.0
experience of your firm in this kind of deal	40.0	54.3	5.7
good business plan	38.5	43.3	17.3
guarantees for failure of delivery or payment	37.1	59.0	2.9
recommendation from your bank	5.7	36.2	57.1
recommendations from your regular commercial partners	24.8	55.2	20.0
juridical form of new partner	7.6	30.5	61.9
advance payment	12.4	40.0	47.6
familiarity with new partner	29.5	52.4	18.1

Organised by groups of enterprises, managers in the food-processing sector (50%), small (42%) and older (41%) firms regarded their own experience in this kind of deal as more important than on average (40%) (Table 25). However, within the food processing sector, managers considered the expected profits (53%) and a good business plan (52) more important than experience. In this sector experience came only third. It was followed by guarantees for failure of delivery or payment (47%). The frequency of answers was almost the same in the case of managers of younger enterprises, as profits and a good business plan are obviously important prerequisites in starting a business. In younger enterprises guarantees for failure of delivery or payment came third and the experience of firm on business deals came only fourth, as they normally have less experience.

Among the more frequently named factors, advance payment (48%), recommendations from bank (57%) and the legal form of the new partner (62%) are not important. The last aspect is solved by legislation in Estonia: all legal forms of enterprises are equal according to the law.

Micro enterprises valued the above mentioned factors less often. At the same time, their managers regarded the familiarity with the new partner to be of higher value than on average, in addition to some other aspects (e.g. advance payment). This means that enterprises rely on personal trust, which makes them more secure in business relations. Cases of using advance payment were met in several sectors. For example, small trade enterprises make advance payments for goods to large producers/suppliers, who would otherwise not be interested in the delivery of small consignments. Small consignments and sums of money are no stimulus for suppliers to offer credit. The shorter life span and other factors of instability, as well as some previous negative experiences, have made suppliers cautious, and so they find it more convenient to require advance payment. In the services sector advance payment is also often used in the cases of longer jobs, when the enterprise has to pay its own employees before the final fulfilment of the contract.

Table 25. If you prepare a new business deal what aspects are relevant for your decision making? By sectors

		Food processing		Trade		Business services	
		Count	Col %	Count	Col %	Count	Col %
Expected profit?	not important					1	2.6
	also important	14	46.7	26	70.3	24	63.2
	most important	16	53.3	11	29.7	13	34.2
Experience in such deals?	not important	2	6.7	2	5.4	2	5.3
	also important	13	43.3	23	62.2	21	55.3
	most important	15	50.0	12	32.4	15	39.5
Good business plan?	don't know	1	3.4				
	not important	1	3.4	7	18.9	10	26.3
	also important	12	41.4	18	48.6	15	39.5
	most important	15	51.7	12	32.4	13	34.2
Guarantees for failure of delivery, payment?	don't know					1	2.6
	not important	1	3.3			2	5.3
	also important	15	50.0	22	59.5	25	65.8
	most important	14	46.7	15	40.5	10	26.3
Bank recommendation?	don't know					1	2.6
	not important	14	46.7	25	67.6	21	55.3
	also important	12	40.0	12	32.4	14	36.8
	most important	4	13.3			2	5.3

Table 25 (continued). If you prepare a new business deal what aspects are relevant for your decision making? By sectors

		Food processing		Trade		Business services	
		Count	Col %	Count	Col %	Count	Col %
Regular business partners' recommendations?	not important	3	10.0	11	29.7	7	18.4
	also important	20	66.7	19	51.4	19	50.0
	most important	7	23.3	7	18.9	12	31.6
Juridical form of new partner?	not important	13	43.3	25	67.6	27	71.1
	also important	15	50.0	9	24.3	8	21.1
	most important	2	6.7	3	8.1	3	7.9
Advance payment?	not important	15	50.0	17	45.9	18	47.4
	also important	13	43.3	16	43.2	13	34.2
	most important	2	6.7	4	10.8	7	18.4
Familiarity of new partner?	not important	4	13.3	5	13.5	10	26.3
	also important	16	53.3	18	48.6	21	55.3
	most important	10	33.3	14	37.8	7	18.4
Other?	not applicable	30	100.0	37	100.0	38	100.0

Entrepreneurs answered that on the whole they do not prefer people in business transactions on the basis of their religion, ethnicity, etc. However, case studies showed that nationality and culture are important issues influencing the behaviour of businesses and these issues must be considered when making deals.

When entrepreneurs consider new business transactions they estimate already existing business relations with customers/suppliers as important as the business deal and contractual terms (77% of all firms), but in a few (6.7%) cases they are even more important than the business deal and contractual terms (Table 26). Organised by groups of enterprises, the importance of the existing relationships with customers and suppliers is greater among service enterprises, small (10–49 employees) and older enterprises. Seventeen (16%) entrepreneurs answered that the existing

business relations were less important than the business deal and contractual terms. Among these were more young, micro and food processing enterprises.

The answers given by managers from the trade sector may be explained by frequent changes in the trade sector and strong competition (new retail trade chains entering the national market). The activity of newly established and micro firms is also subject to more frequent changes and instability, which can be connected with market search and survival efforts.

The importance of existing business relations with customers/suppliers was confirmed by managers in case studies, who estimated co-operation with long-term clients and suppliers highly.

Table 26. When you consider new business transactions which role do existing business relations with customers/suppliers play in your considerations? (row %)

	as important as the business deal			more important than the business deal			less important than the business deal		
	Count	Row %	Col %	Count	Row %	Col %	Count	Row %	Col %
food processing	23	76.7	28.4				7	23.3	41.2
trade	28	75.7	34.6	1	2.7	14.3	8	21.6	47.1
business services	30	78.9	37.0	6	15.8	85.7	2	5.3	11.8
0–9 employees	33	68.8	40.7	2	4.2	28.6	13	27.1	76.5
10–49 employees	48	84.2	59.3	5	8.8	71.4	4	7.0	23.5
0–5.5 years	35	79.5	43.2	1	2.3	14.3	8	18.2	47.1
over 5.5 years	46	75.4	56.8	6	9.8	85.7	9	14.8	52.9
	81	77.1	100.0	7	6.7	100.0	17	16.2	100.0

Types of agreement

In 17% of enterprises there were no agreements with customers. 54% had oral, and 74% written, agreements with customers. Agreements with suppliers were oral (31%) or written (63%). The managers who had no agreements with customers (e.g. in retail trade) or who used verbal agreements with customers and suppliers put less importance on the existing business relationships in making deals than the enterprises who used written contracts.

When managers were asked in what circumstances they are happy to base co-operation on just verbal agreement, nearly 62% of those who considered their existing relationships important answered that these were regular customers/suppliers. Those who considered the existing relationships less important than deals had no preference with whom to make verbal agreements. Hence, we can conclude that the more entrepreneurs rely on personal trust in their relationships, the less important will institutional trust (or contracts) become.

When deciding on the type of agreement, entrepreneurs consider a number of criteria, all of which were estimated as very important by the enterprise groups under investigation. The most frequently mentioned were: previous experience with this firm (96.2%), reputation of the customer/supplier (93.3%), size of the expected deal (89.5%), guarantees with respect to delivery or payment failure (78.1%) and recommendations from business partner (76.2%) (Table 27). All criteria were estimated higher to some extent by entrepreneurs from the business service sector and small firms (10–49 employees). The opinions of enterprises, when grouped by age, were not so clear. However, recommendations from a business partner and guarantees with respect to delivery or payment failure were less frequently mentioned by younger firms.

Table 27. Criteria entrepreneurs consider when they decide on the type of agreement, col % of respondents

	Food sector	Trade	Business sector	0–9 empl	10–49 empl	<5.5 years	>5.5 years	Total
Reputation of the customer /supplier	24	36	38	43	55	41	57	98
	80.0%	97.3%	100.0%	89.6	96.5	93.2	93,4	93.3%
Recommendation from business partner	19	27	34	32	48	30	50	80
	63.3%	73.0%	89.5%	66.7	84.2	68.2	82.0	76,2%
Previous experience with this firm	29	36	36	45	56	42	59	101
	96.7%	97.3%	94.7%	93.8	98.2	95.5	96.7	96.2%
Size of the expected deal	22	35	37	38	56	40	54	94
	73.3%	94.6%	97.4%	79.2	98.2	90.9	88.5	89.5%
Guarantees with respect to delivery of payment failure	17	32	33	31	51	33	49	82
	56.7%	86.5%	86.8%	64.6	89.5	75.0	80.3	78.1%
Total	30	37	38	48	57	44	61	105
	100.0%	100%	100.0%	100.0	100	100.0	100.0	100.0

Managers from the food processing and trade sectors have confirmed in case studies that written agreements are inevitable if credit payment terms have to be determined. If payments in advance or cash payments are used, then written agreements are not necessary (e.g. farmer, sole proprietor). Small firms need written agreements as a defence against monopolies. Business service firms said that they needed written agreement to determine the rights and responsibilities for both sides of the contract.

Terms of payment

The majority of payments were arranged by customers via bank transfers (92%), but (often in parallel) in 45% of enterprises customers pay also by cash (Table 28). Credit was for a period of up to 1 week or up to 1 month (56–57%), but enterprises rarely gave credit for more than 1 month (11%). It is quite likely that financial constraints prevent small enterprises offering credit for longer terms. For that reason micro enterprises used payment by cash more frequently and gave less credit than small enterprises. Trust was assessed as being very important by entrepreneurs (for nearly 92% of firms who have gave credit) in making a decision about offering credit to their customers.

With regards to the usual payment terms expected by suppliers, 95% of those firms who had suppliers (78 firms) and 70.5% of all enterprises (Table 29) answered 'bank transfers'. In a few cases micro enterprises used cash on delivery more frequently. Credit was more usually offered for up to 1 week and up to 1 month (47.6% and 56.2% of respondents respectively). 18% gave credit for more than 1 month. The fact that most suppliers served enterprises regularly (i.e. long-term) created a trustworthy environment for business relations between enterprises and suppliers. Therefore entrepreneurs estimated trust to be very important (92.5% of those offering credits) and important (6%) for making decisions about offering credit to suppliers. The managers in the case studies explained that a new client usually starts co-operation with an advanced payment, and only after a probation period can he receive favourable payment terms.

Table 28. Usual payment terms enterprises offer to their customers, Col%

	Food sector	Trade	Busin. sector	Total	0–9 empl	10–49 empl	0–5.5	>5.5
Cash payment on delivery	13	25	9	47	24	23	19	28
%	43.3	67.6	23.7	44.8	50.0	40.4	43.2	45.9
Bank transfer	27	33	37	97	42	55	41	56
%	90.0	89.2	97.4	92.4	87.5	96.5	93.2	91.8
Credit up to 1 week	15	23	21	59	21	38	27	32
%	50.0	62.2	55.3	56.2	43.8	66.7	61.4	52.5
Credit up to 1 month	20	23	17	60	23	37	29	31
%	66.7	62.2	44.7	57.1	47.9	64.9	65.9	50.8
Credit more than 1 month	2	7	3	12	3	9	4	8
%	6.7	18.9	7.9	11.4	6.3	15.8	9.1	13.1
Total	30	37	38	105	48	57	44	61

Table 29. Usual payments terms expected by suppliers, Col%

	Food sector	Trade	Busin. sector	Total	0–9 empl	10–49 empl	0–5.5	>5.5
Cash payment on delivery	9	3		12	8	4	6	6
%	30.0	8.1		11.4	16.7	7.0	13.6	9.8
Bank transfer	28	36	10	74	33	41	31	43
%	93.3	97.3	26.3	70.5	68.8	71.9	70.5	70.5
Credit up to 1 week	15	29	6	50	20	30	22	28
%	50.0	78.4	15.8	47.6	41.7	52.6	50.0	45.9
Credit up to 1 month	20	32	7	59	24	35	28	31
%	66.7	86.5	18.4	56.2	50.0	61.4	63.6	50.8
Credit more than 1 month	3	15	1	19	4	15	4	15
%	10.0	40.5	2.6	18.1	8.3	26.3	9.1	24.6

When dealing with regular suppliers and customers, entrepreneurs used the following forms of transactions: commercial credit (68.6% of firms) and mutual guarantees (54%).

Credit transactions and the role of trust

Credits received

Access to capital/finance remains a constraint on enterprise development in Estonia, although the supply of finance has been improved compared with the initial transition period. But enterprises are not very active to borrowing money from the bank, or lending their enterprise's money. Entrepreneurs explained their modest borrowing from banks by the high cost of loans and the lack of collateral in small firms. However, 71 (67.6%) enterprises in the sample used different sources to find external capital for the development of enterprises. Some (5) enterprises used more than one source.

Nevertheless, the most numerous group of entrepreneurs (nearly 26% of respondents) in the current survey borrowed money from banks. This was followed by borrowing from business partners (14%), family (8.6%) and friends (5.7%) (Table 30). There were also some differences in credit sources between different groups of firms, although because of the very small number of respondents in each group, it is not possible to generalize the results. In our sample young and micro enterprises borrowed more frequently from family, friends, while older enterprises and those with 10–49 employees more often borrowed money from business partners and banks. The latter case can be explained by a shortage of collateral in young and micro firms, which is forcing them to find other financial sources. Collateral was provided to cover bank credits (in all 27 cases), but in some cases also borrowing from friends (2 cases from 6) and business partners (2 cases from 15). In 73% of cases collateral covered the entire loan, in 20% of cases more than half of the value of the loan and in only 2 cases less than half.

Table 30. Sources of capital and required collateral,
% of total number of enterprises interviewed

	a) Received capital %		b) Collateral %		
	0=no	1=yes	0=no	1=yes	No credit from source
Family	91.4	8.6	8.6		91.4
Friends	94.3	5.7	3.8	1.9	94.3
Employees	98.1	1.9	1.9		98.1
Customers	98.1	1.9	1.9		98.1
Suppliers	100				100
Business partners	85.7	14.3	12.4	1.9	85.7
Previous colleagues	100				100
Bank	74.3	25.7		25.7	74.3
State programs/donors	99.0	1.0	1.0		99.0
Other (leasing)	86.7	13.3	13.3		86.7

Below we try to find out if there are any differences in the importance of trust towards business partners, customers and suppliers between those entrepreneurs who have taken loans and who have not. As the number of those who have got a loan is small, our analysis did not reveal statistically significant differences, but some remarks can still be made on the basis of the answers given. For example, the majority of the respondents said that relationships with the business partners, customers and suppliers were very important for them (on a scale from 1 – very impor-

tant to 5 – no importance). The same answer was also given by the majority of those who had taken a loan, regarding trust as "very important". However, the answers vary: if the creditor was a bank or a business partner, some enterprises attached less importance to trust saying it was "important"(2) or of "average importance"(3). Despite the small number of lenders, we can conclude from this that when lending from banks or business partners entrepreneurs rely on agreements made, or so-called institutional trust. Similar opinions were also observed in assessing the importance of trust by lenders in their relationships with customers and suppliers.

In those few cases where less than 100% security was provided, entrepreneurs assessed highly (on the scale 1=very important to 5=of no importance) the role of trust in the decision of the lender to give them the loan.

Credits given

Twenty per cent of enterprises lent money, mostly to employees in firms with 10–49 employees. Enterprises that lent money also considered trust between business partners, customers and suppliers very important.

Governance of credit agreements

Credit transactions were regulated by oral or written agreement, in a few (5) cases there were no regulations (Table 31). In 20% of cases, oral agreement was used with family, friends and business partners. The majority of agreements (73% of all agreements) were in written form, normally with banks, but also with business partners. Written agreements give guarantees for managers in court in case of not receiving money for delivery. A few written agreements were also mentioned with friends (3 cases), family (1 case) and other sources of finance. Credit agreements with banks covered the amount of money, maturity, interest, collateral, default provision. The agreements with other sources included elements such as the amount and maturity. The way agreements are made with banks is regulated mostly by the banks themselves to guarantee that the enterprises will pay the loan back. Thus, relationships with banks are based on institutional trust. The fact that at least half of the respondents used verbal agreements in getting credit shows trust between partners. Unfortunately, we do not know how much money was involved in the case of oral agreements.

Table 31. Types of agreements which regulate enterprises' credit transactions (both receiving and giving credits), % of agreements

	No regulations		Oral agreement Written contract		Written contract		Total
	No	%	No	%	No	%	No
Family	3	33.3	5	55.6	1	11.1	9
Friends			3	50.0	3	50.0	6
Customer					1	100.0	1
Supplier							
Business partners	1	6.3	7	43.8	8	50.0	8
Bank	1	3.7			26	96.3	27
State programs/donors					1	100.0	1
Other: leasing contracts					14	100.0	14
Total	5	6.8	15	20.2	54	73.0	74

The problem with crediting is connected with both sides, money supply and demand.

Hansapank focuses mainly on medium-sized enterprises. To make the credits meant for small and medium-sized enterprises simpler and clearer, Ühispank altered the terms of credits. The following amendments have been made (Äripäev. 10.12.2002): the sum offered as a credit is smaller (10 000 croons); the requirement to provide additional documents was reduced; no self-financing is now required, provided that the share of net equity in the balance is at least 20% and the value of collateral is sufficient to guarantee the loan; as collaterals real estate, transportation vehicles and additional guarantees of the guarantee fund are acceptable. As a rule, the owner(s) are required to guarantee the credit.

Cooperation with other enterprises

Nature of cooperation relationships

58% of enterprises surveyed co-operated with other entrepreneurs in ways other than selling to them or buying from them. Cooperation was more frequently mentioned by larger (63% of firms with 10–49 employees) and older (61% trading >5.5 years) firms and those from business service sector (76%). The most popular forms of co-operation as first priority were: exchange of information, joint training of employees, joint production/services and exchange of advice (Table 32). To sum up, of all three priorities, the main form of co-operation were exchange of information (90.2%) and advice (42.6). Co-operation in training employees came third (31.1%).

Table 32. The ways entrepreneurs cooperate with other businesses/entrepreneurs in order of priority, % of those cooperating (61 firms)

	1 st priority	%	Total	%
Exchange advice	7	11,5	26	42,6
Exchange technology			7	11,5
Exchange of information (e.g., about markets)	29	47,5	55	90,2
Joint marketing or selling	3	4,9	6	9,8
Joint research	1	1,6	5	8,2
Joint training of employees	8	13,1	19	31,1
Joint production/services	8	13,1	11	18
Joint purchasing of supplies/services/raw materials	4	6,6	4	6,6
Joint security measures	1	1,6	1	1,6
Total	61	100.0	61	100,0

Business partners were located in the same place, but also in the rest of Estonia and in foreign countries. Co-operation was initiated mainly by the respondents themselves or regular partners.

Co-operation has a direct effect on trust relationships. In choosing terms for making agreements, co-operating firms rely largely on personal trust, as they are ready to make verbal agreements mostly with regular customers and suppliers (57% of those co-operating), to a smaller extent with friends and partners recommended by a trusted person (20% in both cases). Co-operating firms more often regarded trust with business partners as very important, and also in the cases of crediting customers or suppliers. Co-operating enterprises used aid from business partners, business associations and their own employees more often, and less from friends and family. This means that participation in co-operation networks makes this possible for them.

Value of cooperation to the success of business

The value of co-operation was assessed highly by 57%, and lowly by 43%, of those who were co-operating (33% and 25% of the total sample respectively). All the respondents who attached great importance to co-operation with other enterprises regarded trust in business partners as "very important", although the statistical relation is not significant.

Analysis of the influence of co-operation on the performance of an enterprise reveals that those who co-operate have higher satisfaction in their results (Table 33). The greatest difference was found in the satisfaction with the level of profits. If we combine the answers "satisfied" and "partly satisfied" the difference is as high as 30.6% (86.4%–55.8%). As was shown above, the main forms of co-operation are exchange of information and advice. We can, therefore, draw the conclusion that, relying on the satisfaction of enterprises, co-operation has had a positive effect here, especially as profits far as are concerned.

Table 33. Cooperate with other businesses/entrepreneurs and business performance

	Do not cooperate			Yes, cooperate			Total		
Satisfaction with the performance	No.	Row %	Col %	No.	Row %	Col %	No.	Row %	Col %
Level of sales									
Not satisfied	9	69.2	20.9	4	30.8	6.8	13	100	12.7
Partly satisfied	26	46.4	60.5	30	53.6	50.8	56	100	54.9
Satisfied	8	24.2	18.6	25	75.8	42.4	33	100	32.4
	43	42.2	100.0	59	57.8	100.0	102	100	100.0
Level of profits									
Not satisfied	19	70.4	44.2	8	29.6	13.6	27	100	26.5
Partly satisfied	20	37.0	46.5	34	63.0	57.6	54	100	52.9
Satisfied	4	19.0	9.3	17	81.0	28.8	21	100	20.6
	43	42.2	100.0	59	57.8	100.0	102	100	100.0
Personal goals									
Not satisfied	10	62.5	24.4	6	37.5	10.7	16	100	16.5
Partly satisfied	25	45.5	61.0	30	54.5	53.6	55	100	56.7
Satisfied	6	23.1	14.6	20	76.9	35.7	26	100	26.8
Total	41	42.3	100.0	56	57.7	100.0	97	100	100.0

As could be expected, co-operation and membership of a business association are connected. For example, 77.5% of the members of business associations co-operated, while 79.5% of those who do not belong to associations did not co-operate. Of the members of business association, 83.3% appreciated co-operation highly, whereas co-operation was less important for enterprises that were not members of associations.

The managers in the case study mentioned the need for exchanging information and valued this type of co-operation highly.

Governance of cooperation relationships

In nearly a third (of those who cooperated) of cases, the co-operation between partners was not regulated. In the other cases they were regulated by oral or written agreements. The entrepreneurs were happy to base co-operation on just a verbal agreement if the business partner was a regular customer/supplier (98.4% of those cooperating and 57.1% of respondents), if the partner was recommended by people who they trust (36% and 21% respectively) and if a partner is a friend (32.8% and 20% respectively). Therefore, long-term business relations and personal trust are important here.

Intra-organisational relationships

Relations to managers

Half of the firms interviewed had more than one manager. The other manager most frequently dealt with sales and marketing (32% of respondents), financial management (18%) and technology (13%) (Table 34). 98% of entrepreneurs could trust their managers to make decisions in the interest of their company (64% said –absolutely (1) and 34% assessed trust with 2 points on a scale of 1–5).

Table 34. The areas managers are responsible for

<i>Areas</i>	No	Yes
Financial management	31.4	18.1
Personnel	44.8	4.8
Technology	36.2	13.3
Sales & Marketing	17.1	32.4
Strategic Development	44.8	4.8
Other (please specify)	48.6	1.0

Relations to employees

When selecting new employees, the first priorities which managers use are professional experience (61%), recommendations (12.4%) and personal characteristics (11.4%) (Table 35). If the highest 3 priorities are considered together, the ranking of criteria is the same as the ranking according to first priorities (90.5%, 62.9% and 50.5% respectively). The fourth most frequently mentioned characteristic was motivation (40%). Other aspects were less important. Entrepreneurs could trust their employees to work effectively when they are not supervised (36% entrepreneurs estimated ‘absolutely’ and 46% assessed by 2 points on a scale of 1–absolutely – 5–not at all).

Table 35. Criteria used by entrepreneurs to select employees

	1 st priority		Total	
	Count	%	Count	%
I know future employees	11	10.5	21	20.0
Recommendations	13	12.4	66	62.9
Skills level				
Professional experience	64	61.0	95	90.5
Age			12	11.4
Gender				
Motivation	3	2.9	42	40.0
Personal characteristics	12	11.4	53	50.5
Other (please specify)	2	1.9	3	2.9
Not applicable	2	1.9	23	21.9

There seems to be a connection between the trust of leaders and employees. Those who trust their leaders completely (only 53 firms that had leaders could answer) also trust their employees completely (44.1%) or almost completely (41.2%). Of those who trust their leaders almost completely, 55.6% also trust their employees almost completely. If we consider the criteria for selecting personnel and trust together, we can see that the managers trusting their leaders and employees checked the employees' criteria less thoroughly.

Institutional and social environment

The issues of institutional trust were actively discussed in Estonia last autumn. A short overview of the results of last polls and discussions of sociologists with references is included below.

Strong trust in state institutions is one of the main ways democracy works. In recent years, however, this trust has notably diminished in Estonia. The public opinion poll¹ in autumn 2001 tried to identify the causes of low political trust and connections with other problems of society (Vetik, 2002). The survey indicated that 36% of the respondents trust Riigikogu (the Estonian parliament), that trust in political parties has dropped to 20%, that only 13% of people think Estonian society is fair and that two-thirds of the responders want "a strong leader who would put things into order". Is there any reason on the basis of these figures to state that democracy in Estonia is in danger? In order to answer this question we should place the Estonian figures in a broader context. It appears that political trust has declined considerably in most of the democratic states throughout the world in recent decades².

The low level of political trust is not only a problem of the political system but also a problem of society as a whole. There is no reason to compare political trust e.g. 10 years ago and today, because there are different mechanisms acting between policy and society at different times. 10 years ago we were united by a common goal and politicians were on the so-called front line. Today resistance to an external enemy has been replaced by internal social oppositions and the meaning and functions of political trust in society have changed.

¹ The survey was ordered by the Chancellery of the Riigikogu and was carried out by a research group of the Institute for International and Social Studies at Tallinn Pedagogical University

² Source: World Values Survey 1980-84, 1990-93

As for the business environment, it is necessary to consider the gradually changing environment depending on the taking root of market economy principles and changes in government regulation. The elements of a market economy started to find their place in the entire planned economy environment through a step by step removal by the government of the administrative and legal barriers and preparation of the conditions for business development.

The market research firm *Saar Poll (2000)* has conducted annual public opinion polls in Estonia since 1995 with the aim of learning about the trends of changes in people's attitudes in relation to social development tendencies. These polls indicate that people's trust in the Prime Minister, Government and Parliament has gradually diminished, albeit with some rises in 2001 and in 2002. Trust in the Bank of Estonia (Eesti Pank) has risen in recent years. Trust in the Defence Forces, Border Guard and Police has risen slightly, as has trust in local government (Table 36).

Table 36. Trust in Estonian state institutions
(% who answered "trust completely" or "some trust")

Year	President	Government	Parliament	Local Government	Police	Eesti Pank	Court	Press
1995	66	53	49	46	30	44	38	61
2000	58	34	32	45	44	48	44	48
2002	71	55	44	56	51	...	50	47

Source: Saar Poll (2000)

In the same questionnaire, around half of the respondents were of the opinion that the Government has in general succeeded in the development of entrepreneurship during the last 10 years, i.e. since regaining independence in Estonia. Two-thirds of the respondents answered the question about which national programs they would most support with the reply 'health care and medical assistance programs'. The second place was occupied by new job creation programs and the third place by support to young families. In middle place among the programs was support for enterprise development. Answers to questions about various other programs related to entrepreneurship environment (e.g. limitation of interests of monopolistic enterprises; inviolability of property; elaboration of laws, etc.) indicated that a lot has changed, but that there is still a lot to do to improve the external environment for the development of entrepreneurship.

Surveys carried out by sociologists analyse the attitudes of people, which serve as a basis for drawing conclusions that the background of low political trust in Estonia is the sharp social stratification and uncertainty of many people about the future. The major problems according to the survey are welfare and unemployment. Analysis of long-term trends indicates that people worry most about their economic subsistence and health. The mounting number of welfare related problems influences peoples' understanding of the state and its role. In the first half of 1990 most of the post-communist countries were characterised by the attitude "as little state as possible". Because leftism as an ideology had compromised itself, they inclined to the other extreme. Recent studies demonstrate that people's attitudes have changed. A cluster analysis demonstrates that bearers of undemocratic attitudes account for about one-sixth of the responses, and this is also typical of a developed democracy (Vetik, 2002). Estonians do not want any alternatives to democracy. Only 10% do not consider democracy to be the best form of governance.

The following analysis of the results of the empirical study seeks to evaluate the role of trust of entrepreneurs on their behaviour in communication with clients, contractors, business partners and public sector institutions.

Membership of business associations

38% of enterprises from the sample were members of business associations, chambers or local public organisations. Most active were small firms (10–49 employees) (56% compared 17% of micro-firms), firms from the business services sector (53% compared with 24% of trade firms) and older firms (47.5%). However, 70% of enterprises assessed their membership to be of little value and only 30% of high value. Understandably, enterprise groups with a level of higher membership assessed the value of membership to the success of the business to be higher.

Analysis reveals that membership supports business relationships in the direction of strengthening institutional trust. This becomes evident in entrepreneurs' behaviour when they have to decide to whom to turn when they need assistance and advice in their business. Analysis shows that the members of business associations turn more often to established and regular business partners (65% of members), next to consultants or business support agencies (50%) (Table 37). As is logical, these two preferences of getting help were highly valued (58% for all) for success in business by the members who attached greater importance to membership of business associations. Thus, over half of the members of business associations rely on both personal and institutional trust. A considerably smaller number of entrepreneurs turned to business associations or employees (both 22.5%), though still more than the non-members do. Members of business associations listed fewer preferences on who they would prefer to make deals with; however, some preferences were mentioned by only 10% of all enterprises under survey. To sum up, turning to more 'anonymous' sources prevailed among the members of business associations (72.5% compared with 41.5% of non-members), which obviously became possible thanks to contacts with the business network based on membership.

Non-members turned first to employees (69%) when seeking help, followed by regular business partners (65%) and family and friends (43%). Thus, non-members rely more on personal trust, turning to their employees, friends and regular business partners. Non-members also attach somewhat less importance to co-operation in the success of their business (29% compared with 40% of members).

The managers in the case studies estimated positively an opportunity to get information about markets, clients and suppliers from the Chamber of Industry and Commerce.

Members of business associations regard trust towards business partners as more important than towards customers and suppliers (in crediting). The greatest difference between members and non-members was revealed in evaluating the importance of trust in relationships with business partners. 67.5% of the members regarded these relationships as very important, while only 38.5% of the non-members did so (Table 38). Also, 95% of the members considered the role of existing business relations important or even more important than the business deal, whereas 23% of non-members (5% of members) estimated these relations less important. These estimates allow us to draw the conclusion that for members of business associations' personal trust is important in their relations with business partners, customers and suppliers.

Table 37. To whom do you turn when you need assistance and advice in your business? How important is trust in comparison with other factors?

	Non-members			Members			Total		
	Count	Row %	Col %	Count	Row %	Col %	Count	Row %	Col %
To whom do you turn?									
Not applicable	31	59.6	47.7	21	40.4	52.5	52	100.0	49.5
No assistance needed	4	44.4	6.2	5	55.6	12.5	9	100.0	8.6
Employees	45	64.3	69.2	25	35.7	62.5	70	100.0	66.7
Family, friends	28	75.7	43.1	9	24.3	22.5	37	100.0	35.2
Established and regular business partners	42	61.8	64.6	26	38.2	65.0	68	100.0	64.8
Consultants, business support agencies	26	56.5	40.0	20	43.5	50.0	46	100.0	43.8
Business associations, chambers	1	10.0	1.5	9	90.0	22.5	10	100.0	9.5
Local authorities	18	78.3	27.7	5	21.7	12.5	23	100.0	21.9
Trust importance									
Very important – 1	47	61.8	77.0	29	38.2	82.9	76	100.0	79.2
2	8	72.7	13.1	3	27.3	8.6	11	100.0	11.5
3	5	62.5	8.2	3	37.5	8.6	8	100.0	8.3
4	1	100.0	1.6				1	100.0	1.0

Analysis of the main constraints for business development when the business was being set up revealed an interesting fact – the percentage of those who had no problems was higher among the non-members than among the members of associations (65% compared with 55% of members). Non-members had more problems with capital and finding markets during start up, while members had relatively more problems with personnel, legal regulation and getting information. This allows us to conclude that it was the problems that made these firms turn to business associations for assistance, that is, they began to rely on institutional trust. If we analyse the satisfaction of firms with their business performance in 2001, then, in general, more firms from non-members were not satisfied with business performance, although the satisfaction with regards to different goals (turnover, personal goals and profit) was ranked similarly among firms from both groups. Consequently, membership of business associations has helped make the business successful.

Table 38. Importance of trust in different business relations and membership of business associations.

	Non-members			Members			Total	
	Count	Row %	Col %	Count	Row %	Col %		
Importance of trust in relationships with business partners								
Not applicable	35	77.8	53.8	10	22.2	25.0	45	42.9
1	25	48.1	38.5	27	51.9	67.5	52	49.5
2	5	71.4	7.7	2	28.6	5.0	7	6.7
3				1	100.0	2.5	1	1.0
Total	65	61.9	100.0	40	38.1	100.0	105	100.0
Trust importance if to decide to offer credit to customers								
1	32	57.1	76.2	24	42.9	82.8	56	78.9
2	7	77.8	16.7	2	22.2	6.9	9	12.7
3	2	50.0	4.8	2	50.0	6.9	4	5.6
4	1	100.0	2.4				1	1.4
5				1	100.0	3.4	1	1.4
Total	42	59.2	100.0	29	40.8	100.0	71	100.0
Role of existing business relations with customers/suppliers								
as important as	47	58.0	72.3	34	42.0	85.0	81	77.1
more important	3	42.9	4.6	4	57.1	10.0	7	6.7
less important	15	88.2	23.1	2	11.8	5.0	17	16.2
Total	65	61.9	100.0	40	38.1	100.0	105	100.0
Trust importance if suppliers offer credit to enterprise								
1	40	64.5	90.9	22	35.5	95.7	62	92.5
2	3	75.0	6.8	1	25.0	4.3	4	6.0
3	1	100.0	2.3				1	1.5
Total	44	65.7	100.0	23	34.3	100.0	67	100.0

Relations to authorities

A relatively large number of entrepreneurs considered the relations between official bodies and private firms to be helpful, for example the courts were estimated to be helpful by 80% of respondents, regional legislative – 68%, federal legislative – 43%, regional government – 42% (Table 39). In general, the firms in business services estimated higher all these relations, apart from the relations with regional government. This can be explained by the special characteristics of a part of the business services sector (e.g. among design services), which needs advice and decisions (building permits, master plans etc) from official bodies in their everyday work. Local governments are more important for the trade sector, as firms in this sector need licences to be in business. For food-processing enterprises relationships with the regional legislature and

courts were helpful, although in this sector the answer ‘helpful’ was given by a somewhat smaller number of enterprises than in the other sectors. At the same time, a large number of entrepreneurs estimated these relations to be more neutral than helpful, and only a few answers estimated relations with official bodies very helpful or as a constraint. This could be explained by the fact that the interviewed enterprises had turned to officials for help relatively seldom or that they had had few problems with inspectors. Alternatively, this might be a sign of certain institutional weaknesses (standards, requirements and organisations).

Table 39. The extent to which entrepreneurs consider the relations between official bodies and private firms as either a help or a constraint to business success

	Very helpful	Helpful	Neutral (neither helpful nor constraint)	Constraint	Major constraint	Don't know	No answer
Federal government		26.7	71.4			1.9	
Federal legislative		42.9	54.3	1.0		1.9	
Regional government		41.9	57.1			1.0	
Regional legislative		67.6	29.5	1.0		1.9	
Local bodies		28.6	66.7	3.8		1.0	
Court	1.0	80.0	15.2			3.8	
Arbitrary court	1.9	19.0	75.2			3.8	
Other (please specify)		1.0					

Contacts with official bodies were to a certain extent affected by the presence of partners in management. For example, federal and regional legislative bodies and the courts were regarded as more helpful by those firms where partners were participating in management. Firms with no partners found regional legislative bodies more helpful. These were production and service enterprises that had problems with rooms or other problems connected with their location. This can be explained by the fact that the majority of such firms were connected only with the local market, where it is necessary to follow the rules of this market. If constraints with regards to legislative and local bodies were mentioned then this was by firms where the partners were participating in capital and know-how. Constraints were mentioned by Estonian firms from the food-processing and service sectors.

When dealing with authorities, the main problems mentioned were: lack of competence of officials (64% of respondents), excessive paperwork (62%) and time consuming procedures (61%) (Table 36). Most estimates were higher in the business service sector, and among small (10–49 employees) and younger firms. In the business service sector lack of competence and favouritism were also more often mentioned; this can be explained by the character of the activities of the business sector. Excessive paperwork was more often mentioned by food-processing, micro and younger enterprises. In the food sector this can be connected with the introduction of EU requirements concerning technological conditions. In the case of micro and younger enterprises registration procedures might cause the problem and, in general, such estimates may be due to their limited resources.

Table 40. When dealing with authorities, do you consider any of the following topics a problem for private firms such as yours? b) If yes, to what extent? % of all respondents

	a) does problem exist?		b) extent of problem?			
	No	Yes	Minor	Moderate	Major	Not applicable
Unfriendly or impolite treatment	61.0	39.0	8.6	26.7	3.8	61.0
Excessive paperwork	38.1	61.9	11.4	33.3	17.1	38.1
Explicit or implicit requirement to give bribes	89.5	10.5	4.8	3.8	1.9	89.5
Time consuming procedures	39.0	61.0	39.0	7.6	27.6	25.7
Lack of competence of officials	36.2	63.8	12.4	29.5	21.9	36.2
Favouritism	62.9	37.1	7.6	22.9	6.7	62.9
Other (please specify)	97.1	2.9		1.9	1.0	97.1

A number of problems in the institutional environment have also been analysed by research on the evaluations of regulatory and enforcement mechanisms. The research undertaken at the firm level³ revealed that the regulations are working as a whole in the country and that the major problems are related to making the existing regulations efficient (Vensel & Wihlborg, 2001). This research has shown that there are insufficient governmental structures, the prestige and efficiency of the court system is low, the experience and qualifications of public sector employees do not always fit with the importance of their function, the legal system and that the supporting institutional environment is not yet satisfactory. On the basis of this survey (in 1998) the managers and entrepreneurs expressed the opinion that the institutional environment was neither steady nor reliable, and that rules and policies changed without adequate notice and opportunity for feedback from businesses (Dillon & Wykoff, 2002).

Relations with local inspectors were mostly described as neutral or friendly. The latter evaluations were given most frequently to tax inspectors (27%), fire inspectors (19%), and to police and labour inspectors (both 13%). Good relationships were appreciated by food-processing firms (fire, trade, police, labour inspector) and trade firms (tax inspector), both of which may have closer contacts with local officials. Relationships with tax collectors are generally close in the case of all enterprises, as they have to submit monthly reports. Enterprises appreciated institutional aspects, namely the technical arrangement of the tax system, as in recent years accounting has become much simpler and declarations can be submitted via the Internet. Transfer to such online services has required great efforts, co-operation and mutual learning between entrepreneurs and employees of the internal revenue office; thanks to this a well functioning system has been created.

Sources of assistance and advice and the role of trust

Many of the enterprises under study (45%) had not relied on assistance in dealing with authorities. However, when assistance was used, its extent was larger in the food-processing sector and smaller in the enterprises of the business services sector. Those entrepreneurs who received assistance in dealing with authorities put help from their employees as the first priority, fol-

³ Monitoring of the Estonian Economic Environment, performed since 1994 by a research group of Tallinn Technical University, headed by professor V. Vense.

lowed by consultants/business support agencies and regular business partners. These three were mentioned as the first priority by an almost equal numbers of entrepreneurs. If the three most frequent answers from each entrepreneur are combined, then 39% of entrepreneurs turned to employees, 31% to regular business partners and 25% to consultants/business support agencies. All in all, about 49% of the enterprises from the sample wanted to turn for assistance to so-called anonymous sources (consultants, business associations, local authorities), while 89% would turn to employees, friends and regular partners. Micro enterprises selected these institutions relatively less often (23% against 70% of the small enterprises). Instead, micro and young enterprises would more often seek assistance from friends and family. By age of enterprises the differences in the preference of sources of assistance were smaller. Still, young enterprises mentioned regular partners and consultants as sources of help somewhat more often. Business associations and local officials were mentioned less often. Still, the above analysis allows us to draw the conclusion that in selecting sources of assistance entrepreneurs rely primarily on personal trust as well as on institutional trust. Of members of business associations, 60% (compared with 41.5% of non-members) would turn to consultants/ business support agencies, business associations and local authorities. Of those who co-operated with other enterprises, nearly 57%⁴ would do so. Earlier research in Estonia has shown little help from business support agencies, which has been explained by as a consequence of a number of problems (e.g. availability of information; competency, etc) (Smallbone et al., 1996; Venesaar, 1999).

Table 41. Do you rely on assistance dealing with authorities?

	Food processing		Trade		Business services		Total	
	No	Col %	No	Col %	No	Col %	No	Col %
Not applicable	33	110.0	40	108.1	50	131.6	123	117.1
other					1	2.6	1	1.0
no assistance	11	36.7	16	43.2	20	52.6	47	44.8
employees	12	40.0	14	37.8	15	39.5	41	39.0
family, friends	11	36.7	5	13.5	4	10.5	20	19.0
established or regular business partners	9	30.0	10	27.0	13	34.2	32	30.5
consultants, business support agencies	6	20.0	14	37.8	6	15.8	26	24.8
business associations, chambers	4	13.3	2	5.4	1	2.6	7	6.7
local authorities	4	13.3	10	27.0	4	10.5	18	17.1
Total	30	100.0	37	100.0	38	100.0	105	100.0

In deciding who to turn for assistance, trust was assessed as very important by 51% of respondents (among those 57% from food, 43% trade and 37% business service sector).

If entrepreneurs experience problems with business partners, they try first to solve the problems together with their partners, and therefore do not turn anywhere else for help (51% of firms). After that, they turn to enchainings firms (26%), common business partners (19%) and the courts (17%). Small (10–49 employees) and older enterprises turned to these sources more often. Of

⁴ Analysis about sources of assistance and advice on the basis of membership has been given above.

those who referred to court, nearly two thirds were members of business associations and co-operated with business partners. Trust was considered important in seeking assistance in solving problems by all groups of respondents.

When analysing the main constraints for business development when they started the business, it is worth remembering that these questions were answered by entrepreneurs in order of priority. As a first priority, capital/finance were the most frequently mentioned constraint (for 53% of enterprises). This was followed by search for markets (14%) and regulations (7.6%) (Table 42). If the top three priorities are calculated together, then capital/finance remains at the first place (66.7). This is followed by problems with personnel (39%) and search for markets (30.5%). Problems with the macroeconomic environment were estimated a little lower (26.7%). However, we should note here that the number of enterprises that answered this question (i.e. who had problems) was relatively small, as in total 61% claimed they had no problems. In trade such enterprises accounted for 81%, among micro enterprises for 73% and among older firms for 70.5%.

Macroeconomic stability has improved substantially in Estonia. In general, the government has kept its deficit and the rate of inflation under control. Foreign direct investment flows are strong and interest rates are down. The banking system is healthy and investment is up. Economists affirm that the government has undertaken a very liberal economic policy in the country, which has been conducive to the overall development of Estonian industry as well as to the general economy (Kilvits, 1998).

Among the main constraints for business development during the start up period, capital/finances were the most important for all sectors. This was especially the case for the food processing sector, where 83% faced these problems. In this sector, problems with equipment (40%) and search for markets (37%) were the next most frequently mentioned. The acuteness of these problems can be explained by the larger proportion of newly established enterprises by status as compared with other sectors, but also by the smaller number of enterprises with partners and the participation rate of the partners. For the trade sector, the most common constraints after capital/finances were problems with personnel (51%), followed by the macroeconomic environment (30%). Among the enterprises of this sector there were more privatised and re-structured enterprises, which face problems with capital. These enterprises are obviously the most strongly affected by increasing competition, a small market and low purchasing power, and so their turnover increased the least and the drop in the number of employees was the greatest. Enterprises from the business services sector put personnel at the second and search for markets at the third place. Problems with regulations, information, search for markets and macroeconomic environment were most frequently mentioned by business services. The latter can be explained as problems for developing sector, where the external environment and markets often change. According to size and age of enterprises, material problems (capital, premises, equipment) were most often mentioned by micro and older enterprises, while problems with employees, information and markets, but also regulations and macro environment, were more often mentioned by young and small enterprises.

While the previous table showed that 41 enterprises (39% of those under survey) only mentioned some problems when starting up, it also showed that 30 enterprises (nearly 77% of enterprises with problems, 28.6% of all respondents) had used some help for solving the problems mentioned above. Although lack of trust only played a role for 4 firms in their decision not to use outside help, for 6 firms lack of trust partly influenced their behaviour. Enterprises who used some help from outsiders received this mostly from business partners (37% of those who received help), friends (27%), family and employees (both 23%). To sum up, half of the respondents used their friends' and family's help, and half the help of people connected with the business (employees, colleagues, partners, customers, suppliers). There were only two cases in which enterprises had turned to local governments. In all cases, firms trusted those providing help to act in their interest. The reason why they trusted is connected with the existence of no alternative (37%) and that they knew those who provided help (86%).

Table 42. Main constraints for business development when business was started by priority, sector, firms' size and age, % of respondents .

Sector, firms' size and age, % of respondents										
	1 st priority		Total		0–9 employees		10–49 employees			
		%		%						
No constraints	6	5.7	64	61.0	35	72.9	29	50.9		
Capital, finance	56	53.3	70	66.7	34	70.8	36	63.2		
Premises	3	2.9	24	22.9	11	22.9	13	22.8		
Equipment			18	17.1	8	16.7	10	17.5		
Personnel	7	6.7	41	39.0	15	31.3	26	45.6		
Information	3	2.9	11	10.5	2	4.2	9	15.8		
Search for markets	15	14.3	32	30.5	16	33.3	16	28.1		
Regulations	8	7.6	23	21.9	9	18.8	14	24.6		
Macroeconomic environment	5	4.8	28	26.7	14	29.2	14	24.6		
Lack of knowledge/experience	2	1.9	4	3.8			4	7.0		
Total	105	100.0	105	100.0	48	100.0	57	100.0		
	Food sector		Trade		Businesses21		0–5.5		>5.5	
	Count	%	Count	%	Count	%	Count	%	Count	%
No constraints	12	40.0	30	81.1	22	57.9	21	47.7	43	70.5
Capital, finance	25	83.3	24	64.9	21	55.3	33	75.0	37	60.7
Premises	9	30.0	10	27.0	5	13.2	7	15.9	17	27.9
Equipment	12	40.0	3	8.1	3	7.9	3	6.8	15	24.6
Personnel	8	26.7	19	51.4	14	36.8	21	47.7	20	32.8
Information	2	6.7	1	2.7	8	21.1	5	11.4	6	9.8
Search for markets	11	36.7	5	13.5	16	42.1	15	34.1	17	27.9
Regulations	5	16.7	6	16.2	12	31.6	8	18.2	15	24.6
Macroeconomic environment	4	13.3	11	29.7	13	34.2	18	40.9	10	16.4
Lack of knowledge/experience	2	6.7	2	5.4			1	2.3	3	4.9
Total	30	100.0	37	100.0	38	100.0	44	100.0	61	100.0

As to the sources of help, our analysis shows that managers relied mainly on personal trust, turning mostly to those they knew – family or closer business contacts. Among these food-processing, small and older enterprises prevailed. Lack of alternatives might have been a problem for older enterprises, as business consulting centres may not have been able to help.

Younger enterprises may have lacked information about consulting opportunities. These ideas are confirmed also by earlier research (Smallbone et al, 1996; Vensel & Wihlborg, 2001)

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Case Study report

Profile of the companies and entrepreneurs

The Companies

The survey sample includes 105 private enterprises from 3 sectors: 30 in the food processing sector, 37 in trade (retail and wholesale trade) and 38 in business services. The Estonian sample includes relatively small firms. The average size of a firm is 14.6 (and by median it is 10) employees. The largest firms are in food processing (median 14), which is followed by trade (10) and business services (9.5).

The share of older firms (over 5.5 years) is higher (58%) in the sample (the share of older firms is higher in all sectors). Only 6 firms have been trading for less than a year and just 8 for 1 to 2.5 years. More than half of the firms in the sample have business partners. 60 firms (57%) in the sample have partners (mainly older, that is over 5.5 years). There are more firms with partners among small (10–49 employees) firms and those in business services. The partners have mainly contributed capital and know-how, and less to management.

Most of the firms in the sample have kept stable employment (around two-thirds of firms). More than half of the firms have increased their sales in 2001 compared with 2000 (more among small and older firms and in business services). Stable sales, like a stable number of employees, were more characteristic for micro and young enterprises. The firms were satisfied more with sales growth and personal goals than profits.

Sectoral differences

Business relationships are significantly affected by differences within sectors, as well as by growth advantages and background. Therefore, we characterize the enterprises of the sectors in the sample. Some very general differences in the size, age, partners, managers as well as business performance may be outlined. These peculiarities may help to explain trust issues in business relationships.

For example, enterprises in the food-processing sector are relatively larger (63% have over 10 employees) but younger (47% below 5.5 years), or, according to the status – newly established or bought (87%, and 1 privatized and 3 restructured enterprises). Also, the food-processing sector has fewer enterprises with partners and the latter are relatively less interested in the enterprises. Still, there have been quite a few enterprises with increasing sales in the food processing sector (60%; there were 27% with stable sales and only 10% with decreasing sales). The managers of this sector are relatively older and the number of employees has fallen significantly (33%; 27% have a stable number of employees), which indicates changes in technology and growth in productivity. Increasing sales may be explained by the fact that customers have started to prefer domestic foodstuffs and so purchases by domestic consumers are increasing.

Among trade enterprises there are more privatized and restructured enterprises (27%, but with 70% newly established) than in other sectors. These enterprises have more problems with capital. By age and partners, trade enterprises are on the average level but their managers are younger. Sales increased less (43%) and the number of employees decreased more (44%) compared to other sectors. Obviously, these enterprises are also most strongly affected by the increasing competition, small market and low purchasing power.

Enterprises from the business services sector have more characteristics of a developing sector, where external environment and markets are often changing. Although the firms surveyed are relatively older enterprises (63% >5.5 years), according to their origins, 84% were newly established or bought and 16% restructured. More enterprises have partners and foreign interest (largest interest in capital (74%), know-how (58%) and management (47%). Managers are mainly at the age of 30–49. 84% of managers have higher education and 69% have previous

management skills. The sector has the largest proportion of enterprises with increasing sales (66%) and enterprises with a stable number of employees (44%).

According to the above characterization, the selected enterprises represent the general development trends of the sectors. However, as the number of enterprises is small, no generalization can be made.

The Managers

Most of the entrepreneurs in the sample were men (70.5%). Entrepreneurs by sex are rather evenly distributed across size groups. Women are more represented in food production firms, but less in the business service sector. There are two main age groups among managers: around two-thirds were in the age group of 30–39 and 40–49. Younger entrepreneurs in the sample represent more frequently micro and younger firms. The entrepreneurs interviewed are highly educated. Two-thirds of the entrepreneurs have a university level education. The rest have secondary and secondary vocational education. Most of those with university level education are in older firms and those with 10–49 employees. Two-thirds of the entrepreneurs have previous experience in management (more in older enterprises).

If firms operate in more than one area, they have different trade (retail and wholesale) and services (only in 5 cases food production) as a second or third activity. The competition conditions affect the relationships between enterprises and their strategies. Depending on the external conditions and internal resources, enterprises may choose several fields of activities. In this, the firms' entry into market was different during the early period of transition compared with the current situation.

In the case of an enterprise's positive development, a change can be from being a "nobody" to having a reputation, where initially the enterprise can rely only on personal business relations and after some time it may become well-known to more customers (collective trust). In transition economies, this process is influenced by institutional development in different periods, as well as various specific conditions connected with the choice of activity, competition in the market and other factors. For example, early in the transition period, Estonian enterprises were characterized by the phenomenon whereby most enterprises took on many activities (registered in the statutes), which were often not linked, when they started up. This was due to the rapidly changing and both politically and economically unstable business environment. Managers tried with many activities to ensure survival of their firm in the market, so that they could choose the activity to which the market situation was more favourable at a certain period. Today, enterprises concentrate more than before on one main activity or related activities, though there are still enterprises that have several different spheres of activity. When evaluating changes in business relations we have to consider that the business environment has become more stable and managers can rely more on formal institutions. Thus, the role of institutional trust has increased in this process.

At the start, firms consider the possibility of dealing with different activities. Firms' experiences show that there is less need for the firms to deal with more than one activity compared with previous years. Instead, they order services (trade, transport, accounting etc) from other, specialized firms. These changes characterize a more stable business environment compared with the period the firms were established.

When estimating differences between sectors it is important to consider in business relations some other intra-sectoral differences; for example, depending on the kind of service, firms offering business services may have quite different customers, legal regulation and supplier-customer relationships (e.g. in retail and wholesale trade).

The business services sector is extremely heterogeneous by nature of its services, customers, cooperation opportunities and the ensuing business relations. For example, design services presume long-term relationships between business partners, their previous planning and precisely fixed tasks in a bilateral cooperation contract, as well as fixing of the payment terms. Some

other services like, for example, legal advice may be a short-term contract, do not require written contracts and there is not always long-term cooperation either. Depending on the nature of services, the role of trust may be different in business relations.

For retail trade, the location of the firm (e.g. residential district or center of town) and the characteristics of customers (e.g. pensioners who need a shop near their home; or tourists and casual consumers) are important. Personal trust between consumers is more apparent in the case of a limited number of clients, where bilateral interests between a firm and consumers may be stronger. This situation is more common for smaller shops in residential districts. In the case of a large shop in the center or some other places of town, collective trust may be in operation, where people choose a retailer on the basis of recommendations or widely spread information about the good reputation of the shop etc. On the firm's side, trusting clients are important for offering different payment possibilities. Over time, contacts between the firm and at least regular clients become closer because of strong competition between supermarket chains.

The managers have to work hard to keep clients, as well as to find new ones. For this purpose they have to improve what they offer (new goods, better services etc). Trade brokers try to get closer to consumers, contacting them personally and making new favourable offers. The managers confirmed that with strong competition it is worth dealing with every client, although in this case the scope of trust extends beyond the number of people we know personally (Putnam, 2000). If smaller retail firms have difficulties surviving, they can co-operate with supermarkets by offering special niche products.

There were different motivations to set up a firm. Early in the transition period, most of the managers were motivated by independence and self-realization rather than financial purposes (Smallbone et al, 1996). Today, starting with businesses is very often an alternative to unemployment and way of supporting one's family. This is explained by the high unemployment and a shortage of jobs' demand in the labour market. The number of sole proprietors, who are engaged in a relatively small business in addition to their principal job, has increased in recent years.

Personal trust is the first priority in relations with friends, colleagues and other good acquaintances. When they start with businesses, they try to keep individual and business aims separated. Usually, contracts regulate business relations. In this case, personal trust is consolidated by institutional trust.

Collective trust may be in operation in the Estonian business community, which is rather small and almost everybody is known, by sectors at least. The managers can use this knowledge for finding clients, suppliers, or employees.

Inter-firm relationships

Customer base

The most frequently served customers for food processing enterprises are distributors/wholesalers and private firms, for trade – final consumers and private firms, and for business services – private firms and public sector institutions. The number of customers served depends on their type: e.g. trade firms have the highest number of customers. A large number of final customers in trade sector mean that it is difficult to maintain long-term relationships with consumers (relatively anonymous relationships) in this sector.

The share of regular customers is estimated to be highest in the food processing sector, and lowest in business services. The majority of enterprises among those with regular customers were of the opinion that the existing business relationships were important. However, the enterprises with a high share of regular customers use more often written contracts (78%), but the share of bank transfers is smaller (86%) than in the case of enterprises with a smaller proportion of regular customers. The payment terms are longer in the case of regular customers.

In *retail trade*, the relations with final consumers are based on the quality of goods and services and how well a firm can satisfy the needs of consumers. The number of final consumers in retail trade can be many times bigger than in other sectors, which diminishes to some extent the role of personal contacts. The selection of the shop by consumer can be based on personal knowledge (long-term relations), but it can also be recommended by friends (colleagues etc) or advertised in newspapers or on TV etc. Therefore, personal trust as well as collective trust are both used here. However, personal trust may appear more important in the case of using credit purchasing. And also, when a consumer has a good experience of purchasing food from a certain place, then over a certain period he/she will do so more often. This means that collective trust can be consolidated by personal trust after some time.

For the *food processing sector*, the main clients are distributors/ wholesalers, but also private firms or final consumers. For the *food processing sector*, the main clients are distributors/ wholesalers, but also private firms or final consumers. These relations are more regulated and depend on personal as well as institutional trust. The relations are traditionally regulated by contracts. The most important issue in the contract is the terms of payment, which depend on trust and its development over time. These relations may start with advance payments for deliveries, but the terms of payment can lengthen as the experience of co-operation develops. Favourable long-standing relationships help to develop personal trust between partners. And in some cases even contracts are not the first priority, depending on the manager's experience in taking a risk. This case was described by a manager who has business relationships with suppliers from foreign countries. He extended these relations to the home country. After some time and because of strong competition, food processing firms as well as other suppliers try to increase their client base and, in addition to distributors, they personally contact final consumers (closer personal contacts), which helps to increase the sales turnover.

Managers explained in the case studies that there are differences in finding clients depending on the time the firm has been in the market. While older firms have regular clients who can be trusted on the basis of long-term cooperation, managers in newly established firms have serious problems finding clients. For that reason, some of the managers from newly established firms personally deal with finding clients through direct contacts (visits).

The managers use different ways of finding clients (telephone catalogues, personal contacts, fairs, informal sources through business partners or business associations etc), although there are differences depending on the sector and market location. Competition is high in trade, where supply of goods exceeds demand. The quality of goods and additional services are important issues in finding clients in trade. The growth in income of the population and opportunities to improve their living conditions are influencing the demand for services and finding new clients. In small local markets (e.g. residential districts) it is difficult to find new services to stimulate clients to increase their spending. This kind of experience has been used more in trade and business services sector. In recent years, enterprises have been looking for direct contacts with customers, that is active marketing with telephone calls to homes or offices are used to offer goods and services. This has undoubtedly been influenced by intensifying competition and the smallness of the domestic market.

Active marketing and finding of new customers does not always lead to trustworthy relationships. Credit granting to customers and its repayment terms depend mainly on the economic situation of the firm. For example, small retail firms cannot afford to give credit. If they allow a credit, it is given in the form of contract as a rule, which provides security that the firms gets its money back.

Enterprises are interested in working with regular customers, i.e. they rely on personal trust, although in business relations they prefer to use written contracts, which gives them guarantees in the case of problems with payments and when they have to turn to court for help.

For *business services*, the main types of clients are private firms, final consumers and public institutions and their relations depend to a large extent on the type of services. In many cases,

the firm and client have to co-operate during rendering of services (to know more about the client needs, e.g. design). In that case, these relations rely on personal contact and personal trust, although the terms of bilateral relations are based on the contract. But in this case payment terms are not as important as the requirements for special work/services. In the case of private firms and final consumers, personal needs and trust are clear, which cannot be said about public institutions (many people are responsible, not clear relations). In this case, institutional trust dominates.

When *searching for clients and suppliers*, managers, if possible, often rely on those companies who are known in the region or country, or who are recommended informally by friends, colleagues and other partners. This is the case for retail trade consumers (described before) where decisions can be based on collective trust.

Collective trust was emphasized by managers in those cases where it was necessary *to exchange information with competitors* and officials. For example, when clients do not make payments for goods in time, managers often decide to disseminate this information among competitors. The managers from the case studies were of the opinion that this kind of co-operation is necessary. In that case clients behaving incorrectly cannot cheat other suppliers. Estonia is a small country, and any mistake in business life may be costly for everybody. If somebody has cheated once, he/she has great difficulties to restore his/her previous status in the market. Exchange of information between competitors helps to improve the business environment, which can be the common interest for all companies who wish to achieve good results in the long term. This kind of activity also helps to develop a trust based environment.

Supplier base

There are 7 suppliers per firm (by median, by arithmetical mean – 27). On average, 90% of the suppliers were used regularly by enterprises with the aim of establishing regular and long-term relationships. Written contracts predominate, but in about one-third of the cases oral agreements are also used.

The role of existing business relationships was regarded as important as the business deal, or even more important by those enterprises that have a smaller proportion of regular customers (i.e. retail firms) but a larger proportion of regular suppliers.

A large number of regular suppliers and case study results indicate that the role of personal trust in business relationships seems to be more important than in the relationships with customers. Obviously, receipt of goods and determining of payment terms are more important, which as a rule are fixed in a contract.

Relationships with suppliers also depend on whether the firm has been on the market longer or whether it is a newcomer. In general, enterprises need not worry about finding suppliers. Finding suppliers seems not to be a problem in trade and food processing sector, where the supply of goods is very active. Usually long-term contacts encourage good co-operation with suppliers. When a new firm is entering into market, relations with suppliers mostly influence the payment terms. The client has to prove his reliability first, and only then can he get more favourable payment terms from suppliers.

Young firms have difficulties in finding a place in the market. A new firm has to prove itself before it can be accepted by clients and suppliers. Surprisingly, younger firms trust their suppliers and clients more than older ones. In their opinion, trust is supported by increasing competition in the market, where only strong and honest companies can survive, i.e. those who can be trusted. Trust is important in bilateral relations and can add stability to the business environment.

Supplier-client relations can be influenced by the size of clients. In some cases suppliers are not interested in small clients. This is so in the case of large-scale producers who have a good reputation among the population (consumers), who produce products that are highly demanded by final consumers and because of that they can exert pressure on smaller clients and require pay-

ment in advance for goods. These clients have to agree with the terms offered, because final consumers demand the products. In this case, the main reason for the behaviour of the supplier is to reduce transaction costs when dealing with small suppliers. Although these small partners have long-term experience with the supplier, such behaviour probably is not an example of trust but competition. Here, contracts can be considered as a safeguard for smaller firms against large-scale suppliers.

Personal trust is especially important in the relationships between small suppliers and clients, which can be irregular (and depend on other factors such as weather) and may be based to a large extent on informal contacts. In this case, no contracts exist and all actions are largely based on personal trust. However, when these clients intermediate goods to other channels (clients, suppliers), they try to do this on the basis of contracts and determine payment terms, i.e. supplementing personal trust with institutional one.

The importance of existing business relations with customers/suppliers was confirmed by managers in the case studies, who valued co-operation with long-term clients and suppliers highly. In managers' opinion, regular supplier-client relations can increase the productivity of managers and other workers in the company, encouraging better results for the company. If somebody makes a mistake, a competitor can take advantage to offer the same services. It is also the case that foreigners have tried to make easy money in Estonia. Those foreign companies that have stayed in the market for a longer time can be trusted.

Managers estimated that trust was very important in transactions. Our survey results showed that with regards to new business transactions a majority of managers (around 84%) estimate the already existing business relations with customers/suppliers to be as important as the business deal or contractual terms, or even more important. Managers from business services, small (10–49 employees) and older enterprises were more numerous among this group. Thus, they rely mostly on personal trust. However, managers emphasized in the case interviews their preference to use written agreements in business transactions.

Those who did not attach such importance to existing relationships were mostly young, micro- and food processing enterprises. The activity of newly established and micro-firms is subject to more frequent changes and instability, which can be connected with market search and survival efforts, where they have to take more risks and trust potential partners. Food processing enterprises are, in terms of trust, influenced by the local environment in which they operate, but there are also more young enterprises among them. The few managers from the trade sector who gave this answer may have done so as a result of the frequent changes in the trade sector, strong competition (new retail chains entering the domestic market) and the active supply of goods, which also cause changes in business relations.

A traditional example of the development of business relations is the change in the enterprises' relations with suppliers over time. The transactions of smaller enterprises may start with their supplier demanding advance payment for goods. If there is good cooperation for a period, they may be able to get credit from the supplier and the payment terms may be prolonged over time. This is fixed in a long-term contract. While these relations develop, enterprises get to know each other, collect information about which goods they want and the skills of keeping the payment terms. Thus, in the beginning, enterprises rely on personal trust, which will be supplemented with institutional trust (contracts) as time goes on. This is influenced by the nature of the transaction, the financial position of the partners, as well as the current institutional framework. The interviews with managers indicated that Estonian enterprises prefer to use written contracts for executing transactions, which provides managers with a kind of guarantee to get money in case the other party for some reason does not pay for the goods. This is also used in accounting for planning the enterprise's activities and checking fulfilment of the plans.

There is a case for mutual relationships between suppliers when it is necessary to exchange information with competitors and officials. For example, when some clients are not making payments for goods in time, managers often decide it is necessary to disseminate this informa-

tion among competitors. The managers from the case studies were of the opinion that this kind of co-operation is necessary. In this case clients who behave incorrectly cannot cheat other suppliers. Estonia is a small country, and any mistake in business life may be costly for everybody. If somebody has cheated once, he/she has big difficulties restoring their previous status in the market. Exchange of information between competitors helps to improve the business environment, which can be the common interest of all companies, who wish to achieve good results in the long term. This kind of activity also helps to develop a trustworthy environment. In the above case, we can state that personal trust was promoted by collective trust, the development of which in turn creates preconditions for the whole business environment to become more trustworthy.

Co-operation

Over half of the enterprises (61) surveyed (incl. more small and older firms and those from the business service sector) co-operated with other firms. The most popular forms of co-operation were: exchange of information, joint training of employees and joint production/services. Firms in business services mentioned co-operation with competitors.

In determining terms of contract, co-operating firms rely largely on personal trust. They are ready to conclude verbal agreements mostly with regular customers and suppliers, and to a smaller extent with friends and partners recommended by a trusted person. Co-operating firms more often attached great importance to trust with business partners, and also when crediting customers or suppliers. Co-operating enterprises more often used aid from business partners, business associations and their own employees, and less from friends and family. Those who co-operate are more satisfied with their results (e.g. level of profits).

In nearly one-third (of those who co-operated) of the cases, co-operation between partners was not regulated. In other cases they were regulated by oral or written agreements. The entrepreneurs are happy to base co-operation on just a verbal agreement if the business partner is a regular customer/supplier, if partner was recommended by people whom the entrepreneur trusted or if partner was a friend. Therefore, long-term business relations and personal trust are important here.

Surprisingly, many companies are members of business associations, chambers and other institutions. If one recollects the previous period where attitudes toward enterprises' associations were rather hostile, then a great change has happened here: enterprises have become more open and daring in searching for assistance. This is also induced by the increasing competition in the market and the need for information. Although they did not evaluate these relationships highly in the survey, the managers in the case studies assessed this participation as an opportunity to find clients and customers, to get other useful information about institutional requirements and the interpretation of laws, and to learn from the experience of other members in different fields.

A manager from the case study described co-operation with another firm of the same industry who agreed to sell products of his competitor. Both firms, using this form of co-operation, are micro firms and they produce food products (bread), but these products are different and do not compete with each other.

Training of employees is used more often through marketing chains and business associations. Larger production firms and suppliers have training courses to introduce their products and how to use these products etc. These courses are meant for employees who are sell these products (retail trade) or use them in services (personal services).

As was shown above, the main forms of co-operation are exchange of information and advice. We can draw the conclusion based on the satisfaction of enterprises that co-operation has had a positive effect here, especially as far as profits are concerned.

Relationships with third party intermediaries

Nearly 77% of the enterprises who had mentioned constraints on business development when they started up (28.6% of respondents), used some help for solving their problems. Half of those which used some help from outsiders, got it from friends and family, others from people connected with their business (employees, colleagues, partners, customers or suppliers). So, our analysis showed that managers relied mainly on personal trust, seeking help from persons they knew, and that both family and business relations were used.

In summer 2002, the majority of managers would ask help from persons directly connected with their business (employees, established and regular partners); next, many of them would turn to business support institutions or local authorities and only one-third of the enterprises would ask help from their family or friends. The three most important sources of assistance are: employees (66.7%), business partners (64.7%), and consultants/ business support agencies (43.8%). Thus, above all, enterprises rely on personal trust in employees and business partners; however, this is supported to quite a large extent by institutional trust where managers are ready to turn to persons and institutions whom they need not know personally.

In all cases, when the business started up, firms trusted those providing help to act in their interest. The reason why they trusted is connected with the existence of no alternative (37%) and that they knew those who provided help (86%).

A large proportion of the enterprises under study (45%) did not rely on assistance in dealing with authorities, but this differs across groups of enterprises.

The managers from the case studies explained that there are more opportunities for assistance for start-ups than for existing businesses. This is connected with the inadequate professional competence of consultants in business advisory centers. Although there have been some development recently, the business support framework is estimated by managers to be rather weak. However, managers said that they would turn for assistance to business support institutions if they could get better advice.

Enterprises solve problems mostly with the help of their employees and regular partners, and also by turning to authorities. The development of enterprises' relationships with local governments and other public offices has been relatively slow. In previous surveys, many managers could not assess the potential role of local governments in their enterprises' development, not to speak of other public offices (Smallbone, 1996). These relationships were mainly based on personal relations. This can be explained by insufficient regulation early in the transition period, where, for example, observance of technical and some other requirements (e.g. ecological environment requirements) was not a problem for enterprises, there was little competition on the market and the share of shadow economy was relatively big. Administrative and budget policy presented few opportunities to local governments or officials lacked experience to influence the development of enterprises. Thus, the relationships of enterprises with public offices have developed from "zero relations" to cooperation in many cases. This indicates the development of institutional trust in these relations.

Intra-firm relationships

Half of the firms interviewed had more than one manager. Other managers most frequently dealt with sales and marketing, financial management and technology. 98% of the entrepreneurs can trust their managers to make important decisions for the company (64% said –absolutely (1) and 34% assessed trust with 2 points on a scale of 1–5).

When selecting new employees, the first priorities which managers look for are professional experience, recommendations and personal characteristics, and motivation. Entrepreneurs can trust their employees to work effectively when they are not supervised (36% entrepreneurs estimated – absolutely and 46% assessed by 2 points on a scale of 1–absolutely – 5– not at all).

Intra-firm relations are mostly based on personal trust. Although contracts are needed between employer and employees by legislation, these contain mainly general responsibilities and salary/wage terms. Everyday relations and decision-making are regulated informally, where personal trust plays a significant role.

In addition, the personal characteristics of the manager or owner, his/her experience and management style, and the history of business development have to be considered. For example, a good manager's experience and democratic management style may cause different business relationships compared with traditional ones in a group of enterprises. The previous experience of manager may influence his next job, using previous contacts etc.

The managers in the case studies valued the participation of employees in decision-making highly. In general, managers stated that when their company was established (5 – 8 – 10 years ago) most of the decisions were made by managers, but now this has changed very much. Now all employees are taking part in decision-making. The manager explained: "It was difficult when the firm started. He had to make more decisions alone. Step by step it became clear that it is necessary to increase co-operation to all staff members. The results of the firm are better now because goods are sold better and customers are more satisfied". Participation of employees in decision-making makes it easier to control employees, because in that case their employees are controlling each other! It is important to use also a good bonus system to stimulate employees. This refers to the development of management culture in companies. However, the managers of some micro-firms said that they make important decisions themselves.

Personal trust can be emphasized when managers are *searching for new employees*. By the law, there is a requirement to announce all employee searches publicly. Nevertheless, it is often the case that employers try to hire people they know personally (due to knowledge about competency, and also other personal characteristics) or they follow suggestions (from colleagues etc). It is only in rather rare cases that managers turn to Labour Offices to find an employee.

Reasons for such behaviour of managers may be the current labour protection measures or acts regulating the dismissal of employees, which stipulate compensations in case of dismissals and terms for notification of dismissal. These measures depend on the length of employment with this employer and may amount to 2–4 times the average wage and 2–4 months when the length of employment was 5–10 years. Thus, it is quite costly for enterprises to dismiss employees. These dismissal requirements are also severe compared with EU and OECD countries. This has been connected by many authors to the relatively low unemployment compensations, as unemployment benefit is barely 10% of average wages and unemployment insurance was introduced in 2003 (Hinnosaar, 2003).

More than half of the firms in the sample have business partners. There were 60 such firms, mostly older and larger firms, and firms in the business service sector. In accordance with the sample estimation, the importance of trust in business relations is more valuable for the firms where partners contribute capital, but also in small and older firms, and in business services.

Actually managers confirmed that partners mostly contribute capital and know-how, and that they are not involved in management. Only when it is necessary to make decisions about investments, are the decisions of partners important. However, sometimes partners make proposals on how to save costs when profit starts decreasing.

Personal trust is important in the *relationships between managers and owners* (partners). Usually, if they are not, they cannot work together or a manager has to leave. Owners are usually looking for high profits and make strategic decisions (e.g. investments). If profit declines, they propose to reduce operating costs.

In evaluating the development of intra-firm relationships we have to take into consideration the fact that, above all, *managers* have had to relearn since the transformation process to understand market economy performance and adapt in the changing business environment. This has definitely influenced the choices of strategies and their planning, with regards to whether managers were capable of preparing these plans themselves or how many of them were willing to use

external help for that (if it was available at all). During the early part of the transition period, training opportunities were very scarce and the business support structure undeveloped. Therefore, most of the entrepreneurs and managers had to manage by themselves, which resulted in learning from experience and mistakes. These lessons may also influence business relations today and under what conditions trust between customers and suppliers develops. In Estonia, it must be emphasized, there is an extremely liberal economic policy, with no government interference in the economy, so that market forces play the major role in transforming the entrepreneurship environment. Thus, the managers had to take risks and often trust new business partners "blindly" in a rapidly changing and unstable environment. However, what circumstances encourage the development of trust in individuals from the point of view of entrepreneurs, as well as in intra-firm relationships, needs a more thorough investigation.

Regulation and the business environment

With the aim of assessment business environment in the country, in addition to case studies, a number of interviews were made with public institutions such as the Tax Office, Estonian Chamber of Commerce and Industry, the Court, Commercial Bank and Ministry of Social Affairs. The explanations were asked for main regulations, their relations with enterprises, problems connected with fulfilment of regulations, etc

Relations with public institutions were differently assessed by managers. Officials in the tax department were assessed by managers to be at a high level, which is a precondition for good co-operation. They described such areas as quick response time and control of existing data, normal attitudes from tax inspectors in answering questions and the giving of explanations as the main advantages. Problematic relations are with the health protection system, where the attitude and behaviour of officials is not uniform and sometimes depends on their previous habits rather than legislation. There are also difficulties with the customs office, and some other departments of local governments. There are a number of problems managers faced in dealing with officials. The main conclusion is that there is a room for improvement.

A manager in the case study explained that administration in public organizations has improved, people are more experienced and knowledge is better than 10 years ago. However, officials are not responsible enough, sometimes answers to letters are late, some documents can be lost, or co-operation between different departments is weak. Design companies have to visit some departments often and know the procedures of document movements, but it is more difficult for private persons to get an answer from public organizations. There was a case where a document waited a year in a department and nobody was interested in answering the letter before a company helped to find out this document and give it to the right person.

Next, we present managers' opinions on how the public sector influences the entrepreneurship environment and also the development of trust in business relations.

In the opinion of managers, their relations with the Tax Board have recently improved (easier to contact, less paperwork, saving time) because of remarkable changes in connection with the implementation of information technology in public services (e-government development), which has improved information exchange between enterprises and public offices. A number of projects have been launched, such as *eTaxBoard* for filling online tax declarations, "*forms in the internet*" to communicate with state agencies, *eJustice* for creating an information system for digital legislative proceeding, *eCounty* to support an Internet-based working environment for filling in documents, learning, supporting local initiatives in rural areas etc.

E-TaxBoard. Since 2000 it has been possible to fill in an *online tax declarations*. In the first stage of the e-TaxBoard application private individuals were offered the option of electronically filing their income tax returns via the portals of two banks – *Hansapank* and *Ühispank*. People can view their social tax notices over the Internet. The second stage of the project embraced the development and launching of the e-services for companies. Using the e-TaxBoard application, the taxpayers can:

- file, view and correct their VAT returns
- file, view and correct their social tax and withheld income tax returns
- submit their VAT refund applications
- view their tax account balances
- view their taxpayer account cards
- make inquiries about other people's outstanding tax debts
- file their personal income tax returns
- view their social tax as calculated and paid by employers, and transferred to the Social Insurance Board.

The introduction of the e-Tax-Board has facilitated the presentation of reports for enterprises, and at the same time, has created control over various costs (e.g. wages costs, social tax, income tax) of enterprises. Therefore, enterprises try to fulfil requirements of the Tax Board and submit reports in time, and this is a reason why enterprises value co-operation with the Tax Board so highly.

The use of information technology has caused problems for micro-enterprises who do not have a computer or whose bookkeepers are not capable of using accounting software. Though reports are accepted by the Tax Board also on paper, enterprise still try to go over to computerized accounting. Initially the trust in electronic transfers was lower, but the fast development of banking in Estonia and experience conducted to development of trust in this sphere.

Relations with banks are estimated by managers to be good, and managers can trust banks. However, they have mentioned a number of problems in relations with banks.

Managers of micro enterprises expressed the opinion that bank employees were not motivated to work with small firms and to explain various options. While larger enterprises are known on the market and banks trust them, small firms who turn to the bank for the first time are unknown and thus banks tend not to trust them. Managers were to some extent discouraged to turn to banks for help, being afraid that they do not understand the terminology used by banks. They also complained about excessive bureaucracy in dealing with banks and about the slow and complicated process of applying for a loan. Entrepreneurs would like to get loans from banks with the same interest rate as large firms and want the fees charged for bank services to be lowered. There is the monopoly status in the banking sector (Swedish ownership), as a result of which bank services are highly priced. One manager said: *"There is no real competition in the banking sector in Estonia, which also makes high prices for banking services possible."* To sum up, micro and small entrepreneurs expect more co-operation from the banks.

Irrespective of the active offers of money by banks in recent years, problems are encountered on both the supply and demand sides. Supply side market constraints become evident when the necessary financing is not available for small- and medium-sized enterprises (SMEs) at acceptable terms. This problem occurs especially in the case of small loans. Demand side market constraints mean that SMEs do not use available financing opportunities, either because of lack of information or insufficient collateral, or because their business plans do not meet the requirements. The last reason is quite frequent in the case of very small (e.g. micro) enterprises. Employees of commercial banks mentioned the need to increase the awareness of entrepreneurs (training, consulting, development of support services, explanation of more complicated bank services).

The **Estonian Chamber of Commerce and Industry (ECCI)** is interested in the establishment of financial, commercial or technical co-operation contacts with companies in Estonia. For that reason the ECCI regularly contacts enterprises, offers them information, cooperation, training courses, consultations, arranging different discussions on amendments of legislation, etc. Entrepreneurs are satisfied with these activities, although those entrepreneurs who are not members do not have such a positive opinion of the ECCI.

The court system has been criticized by managers (low speed of processes, high costs). As for reasons for this, the number of civil cases the court has to hear is tremendous. This number has

increased rapidly after the Tax Board started more actively supervising tax payment by enterprises. Because of the heavy burden of the courts, the time for one case only around 5 months on average. This is the reason why many firms do not turn to the court, but this also depends on the amount of the money involved.

In the *case of a delay of payment*, a number of firms try to get money back. They turn to encashment firms for help. But the results have not been so good. Encashment firms do not wish to deal with small sums and they also need advance payment etc. This information is widely known among managers and many of them admitted that they have turned to encashment firms once, but that they try to avoid them.

Labour Market Regulations play an important role in the business environment, when employment protection legislation is designed to protect workers (i.e. hiring and firing rules). These rules were rather tight in the early period of transition, and despite changes, some constraints cause problems especially for small firms. These include for example redundancy payments that the employer have to pay when terminating a labour agreement and the term of notice enacted by law. These are determined by the length of service. Although the rules valid in Estonia have been estimated to be similar to the average of the European Union, they are higher than in several Central and East European states (e.g. Poland, Czech Republic, Hungary) and relatively strict from the standpoint of employers.

From the point of view of labour market policy, this has been explained as a compensation for the extremely low unemployment benefits. For employers this is an expense that may affect hiring strategies. For example, they should pay more attention to the selection of personnel (high qualifications and good personal characteristics) using recommendations (personal trust) so that later there will be no need to fire the employee.

In conclusion, in Estonia, during the transition period the macro and microeconomic, as well as the institutional environment, have changed and improved, and more stable legal and economic conditions have been created. The managers in the case studies also referred to the stabilizing legal environment, where legislation is better implemented by entrepreneurs, and public officials are more active in supervising firms etc. Although a large proportion of the managers rely on the increasing institutional trust, the other, but smaller group, of managers (as the survey showed) work more on personal trust.

Most of the companies in the survey use contracts in their relationships with suppliers and clients, thus relying on institutional trust. This may be partly explained as a requirement of the institutional environment in Estonia as laid down by law (e.g. terms of payment, customs requirements). While many contacts are developed on the basis of personal trust, contracts seem to be an additional safeguard backing up personal trust. Alternatively, this means that personal trust is decreasing while institutional trust is increasing!

Perception of the domestic trust environment

The previous analysis has shown that trust can develop and change over time, according to circumstances and different relations. The question arises what changes may be necessary for creating a favourable environment for business development in Estonia?

Our analysis revealed that managers of enterprises rely primarily on personal trust in relations with customers, suppliers and partners. It is supported by institutional trust, or to put it differently, managers seek safeguards against failures using assistance and advice from consultants, business support agencies and local authorities. In relationships with suppliers, written agreements are mostly used, although in the case of regular partners, verbal agreements are also often used. This may be explained by the earlier, rather unstable business environment where entrepreneurs experienced failures and disappointment, learning through this to seek guarantees for their deals. Although the business environment has stabilized, several regulations need to be improved for various purposes (to guarantee economic growth, democratize markets, etc.). As a result, legislation is being constantly changed. Additional changes will be caused by institu-

tional harmonization in connection with EU accession. Competition will become tougher and it will become increasingly more difficult for enterprises to stay in the market.

Thus, the road towards a stable economic environment is a slow and long process. Considering the present trends we can assume that personal trust will remain important in business relationships of enterprises and that institutional trust will grow. Based on the opinion expressed by managers, trust relations will remain stronger outside Tallinn, in small towns and rural areas.

Synthesis

Great changes have occurred in both the external and internal environment of enterprises in Estonia during the period of more than ten years since the restoration of national independence. Also, people's attitudes and business ethics have changed (Neivelt, 1999; Vetik 2002). This presumes changes in the enterprises' behaviour and in the mechanisms that influence this behaviour – e.g., in different phenomena of trust.

Today, Estonia has reached a kind of economic and institutional stability. The new regulation system should make inter-firm relationships more predictable and consensual compared with the past, and promote the development of mutual trust in co-operation between businesses. The institutional environment provides safeguards for the implementation of business deals and reduces managers' risks in making decisions. Notwithstanding the considerable structural change in the country and success in many spheres, it is necessary to emphasize that the market orientated reform processes are long-term and gradual and to a certain extent still going on in the country, especially on the micro level. This requires repeated amendments to laws, and other institutional changes in the course of their implementation in order to adapt them to the needs of real life. Therefore, the entrepreneurship environment may still be unstable in details, although the general market economy principles have been accepted by society.

Enterprises' behaviour and business environment

The development of the entrepreneurship environment in Estonia enables an analysis of how changes in the environment influence enterprises' strategies and what the role of trust in different business relations at different periods has been. As the strategies develop according to the dynamic relations in the enterprises' internal and external environment, we can predict that the role of different types of trust can also change as dynamically as changes in the business environment. Of decisive importance here can be considered changes in the institutional development since the beginning of the transition period, which is affected by the development of trust in individuals over time.

Changes in enterprises' behaviour can be understood as the seizing of opportunities in the business environment by the enterprise manager in organizing his/her business. The processes of changing business relations can be analyzed, for example, in enterprise's entrance to the market, in relationships with customers or suppliers, in finding external sources of finance, in relations with public offices, in finding foreign assistance or consultations or in intra-firm organization over time.

Depending on external conditions and internal resources, enterprises may choose several fields of activities when they enter into market. Here, the firms' behaviour was different in the early period of transition compared to current situation. In transition economies, this process is influenced by institutional development in different periods, as well as various specific conditions connected with the choice of activity, competition in the market and other factors. For example, Estonian enterprises early in the transition period were characterized by the phenomenon whereby most of the enterprises took on many, often unrelated, activities (registered in the statutes) when they started up. This was due to the rapidly changing and politically and economically unstable business environment. Currently, firms' experiences show that there is less need for the firms to deal with more than one activity compared with the past. Instead, they order

services (trade, transport, accounting etc) from other, specialized firms. These changes characterize not only the more stable business environment compared to the period when the firms were established, but also the increase in competition and the need for increasing productivity.

Changes in decision making by managers can be found also in cases where they have to find external sources of finance. Many investigations have indicated that the major obstacle in the development of Estonian enterprises so far has been accessibility of sources of finance, especially for small and medium-sized enterprises. They have had problems with the size of loans (the minimum amounts offered by banks are too large), high interest rates, lack of collateral, etc. The survey demonstrated that in the early transition period managers borrowed from their former colleagues, acquaintances, friends and family rather than from banks, because banks did not offer acceptable conditions or enterprises did not want to risk taking out a loan because the manager was not sure he would be able to repay. A reason for the infrequent use of bank loans may be a kind of pattern of behaviour inherited from the past (the Soviet period), when the use of bank loans was limited.

An example may be the behaviour of the enterprise in the payment of taxes, which is essentially influenced by the tax rates and shortage of capital in enterprises (i.e. bad access to external finances). Especially small enterprises mentioned high social tax rate to be paid by employers. This is a reason for the presence of the shadow economy, where enterprises use an informal method (unreported wages) of paying employees for work and can thereby evade social tax. In the early transition period, enterprises could easily reach an agreement with employees for whom the institutional framework in respect to social guarantees was not yet applicable (pension, unemployment benefit, etc). Today, such behaviour is much more complicated, because the payroll tax collection was personalized in 1999, which directly influences the future pension of the employees. This has increased the interest of employees in receiving legal pay. Enforcement of the pension law (2001) has increased people's concern for working in the formal sector. Presently, the Statistical Office estimates that the proportion of shadow economy is about 10% of GDP (compared with 30% in 1994). This has definitely been influenced by better access to finances for enterprises. A change in this that is worth mentioning is that the corporate entities are exempt from income tax on undistributed profits, regardless of whether they are reinvested or retained. This change supports the view that Estonia's corporate tax reform should encourage investment spending (Funke, 2001).

The development of enterprises' relationships with local governments and other public offices has been relatively slow. In previous surveys, many managers could not assess the potential role of local governments in enterprises' development, not to speak of other public offices. These relationships were mainly based on personal relations. This can be explained by the insufficient regulation early in the transition period, when, for example, observance of technical and some other requirements (e.g. ecological environment requirements) was not a problem for enterprises, there was little competition on the market and the share of shadow economy was relatively high. Administrative and budget policy presented few opportunities for local governments or officials lacked experience to influence development of enterprises. Thus, the relationships between enterprises and public offices have developed from "zero relations" to cooperation in many cases.

Conspicuous in intra-firm relations is the behaviour of managers in searching for new employees, where managers try to hire people they know personally (e.g. knowledge about the competency and personal characteristics) or listen to recommendations (colleagues, friends). In rare cases, managers turn to Labour Offices to find an employee. One of the reasons for such behaviour by managers may be the current labour protection measures or acts regulating the dismissal of employees, which stipulate compensations for dismissals and the terms of notification of dismissal. These measures depend on the length of employment with the employer and may amount to compensation equal to 2–4 monthly wages and notification term of 2–4 months if the length of employment was 5–10 years. Thus, it is quite costly for enterprises to dismiss employees. These dismissal requirements are severe when compared with EU and OECD countries.

This has been connected by many authors to the relatively low level of unemployment compensation, as unemployment benefit is barely 10% of the average wage and unemployment insurance was introduced only in 2003 (Hinnosaar, 2003).

Business relationships are significantly affected by differences within sectors as well as growth advantages and the background of sectoral developments. Some very general differences in the size, age, partners, managers' behaviour, as well as business performance may be outlined on the basis of the sample under survey. There are some other characteristics of sectoral differences between firms that can be determined with factors, such as:

- the way enterprise was established (new, restructured, bought)
- markets served (local or foreign market),
- customer base (final customers, firms, public authorities),
- competitiveness of the firm, demand for products (purchasing power of population), etc.

Table 43. Regulation of inter-firm relationships, % of respondents

Type of agreements	Sector			Size group		Age group		
	Food processing	Trade	Business services	0-9 employees	10-49 employees	0-5.5 years	over 5.5 years	Total
Regulation of customer relationships								
No agreements	10.0	40.5		20.8	14.0	20.5	14.8	17.1
Oral agreements	56.7	56.8	50.0	66.7	43.9	50.0	57.4	54.3
Written agreements	73.3	62.2	86.8	56.3	89.5	77.3	72.1	74.3
Regulation of supplier relationships								
Oral agreements	53.3	27.0	18.4	39.6	24.6	25.0	36.1	31.4
Written agreements	83.3	89.2	21.1	47.9	75.4	63.6	62.3	62.9
Regulation of other co-operation relationships								
No regulation	23.3	8.1	18.4	12.5	19.3	15.9	16.4	16.2
Oral agreements	16.7	27.0	34.2	29.2	24.6	27.3	26.2	26.7
Written contract	13.3	29.7	34.2	22.9	29.8	25.0	27.9	26.7
Total no in sample	30	37	38	48	57	44	61	105

The survey results indicate the important role of written contracts in regulating customer and supplier relationships. The results indicate that firms often use different types of agreements in parallel. The managers from the case studies explained that they choose the type of agreement depending on the amount involved in or the regularity of the business relationships. Often single transactions can be made on the basis of oral agreements, but regular transactions are made on the basis of written agreements. Relationships with suppliers are more often regulated by written agreements, except in the business services sector, where suppliers are not of significant importance. Sectoral differences are generally based on the nature of business and the customer base. For example, business service firms in the sample deal with customers and suppliers on the basis of agreements only. The content of business services (e.g. design services) firms in the sample requires more written contracts. At the same time, during the fulfilment of the agreement, the firms often make changes into agreements orally if necessary. Cases were there are no

agreements are most often found in retail trade with final consumers and in the food processing sector with micro firms. According to size groups, micro firms use written agreement less, while there are few differences in the use of agreements by firms' from different age groups.

The nature of other co-operative relationships, such as the exchange of experience and information, does not require special agreements, although there are some forms of co-operation which are regulated by oral agreements. Some other types of co-operation, like personnel training, the exchange of know-how or marketing are regulated by written agreements.

The role of written agreements as a safeguard is frequently confirmed in case studies, where enterprises may need a document for the law courts. Though, in some cases, the use of written agreements was also explained as being useful in long-term processes for planning and checking goals and other responsibilities. Sometimes the agreement was justified as being necessary for the firm's planning process and for the accounting department.

Affected by the fast changes in the business environment in the transition from a planned to a market economy in Estonia, enterprising spirit, the ability to see opportunities and boldness in taking risks were used, in this order, to achieve success in the initial period of transition to market economy. The objectives of enterprises were mostly short-term, due to the unstable environment for activity. Along with the stabilization of the economic situation and development of institutions in the country, enterprises have started to pay more attention to long-term plans, strategic management and the elaboration of visions. This is also evidenced by our analysis of survey results of the role of trust in processes over time in market entry, relationships with customers and suppliers, in managers' decisions on the need for assistance, in planning new business deals and making decisions over agreement forms, payment modes and co-operation in business relations.

The role of trust in enterprises' behaviour and factors influencing this

In different phases of development of the private sector in Estonia, many factors can be detected that have been (and still are to a certain extent) an obstacle to enterprises' performance (e.g. tax system, licensing activities and crediting policy), which in turn have influenced the role of trust in choosing strategies by enterprises. At the same time, an extremely liberal economic policy has been regarded as a lever of fast development of market and competition in the country, and institutional development. This has inevitably influenced business relations and required strategies, which helped enterprises to adapt in the specific (changing) external environment. Based on the distinctive features of groups of enterprises (sector, size, age etc.) we can also find differences in the role of trust on which enterprises rely in their business relations with partners, customers and suppliers, and employees.

A change has occurred in how enterprises enter the market with an increase in the role of institutional trust since the beginning of the transition period, which to a certain extent has even begun to replace the personal trust used in the early transition period. Therefore, enterprises need not undertake, as they did in the past, many activities to ensure their survival in the market. The role of institutional trust has also increased in the search for external finance, which in turn has been influenced by the fast development of the banking sector, whereby the banks have won trust of people. However, banking policies have been quite conservative in respect to small enterprises and banks have only recently started to offer small loans and other new products to enterprises. The entrepreneurship support structures have also developed, offering collateral for loans, starting capital and other services. Statistics indicate that enterprises have increasingly started to trust bank loans to finance their activity. From the aspect of trust, this development can be regarded as a change in personal trust or substitution with institutional trust. However, accessibility of finances is still a big problem for Estonian small enterprises, indicating that improvement of the accessibility of finances is one way to promote entrepreneurship development in the country.

The survey results have shown that institutional trust has a considerable role in customer-supplier relationships, indicated by the important role of written agreements in regulating customer and supplier relationships. The results indicate also that firms often use different types of agreements in parallel (written, oral). The managers from the case studies explained that they choose the type of agreement depending on the amount involved or the regularity of business relationships and some other factors. The use of different types of agreements also depends on sector and size groups, but less on firms' age. On the other hand, the importance of the existing business relations with customers/suppliers was valued highly by managers, which indicates the importance of personal trust in these relations. The case studies show that institutional trust in the form of written agreements can be considered as a safeguard for smaller firms against large-scale suppliers. Therefore, supplier/client relations are not very focused on one form of trust, but rather on both institutional and personal trust.

Personal trust is extremely important when managers are searching for new employees. Although by law the announcement of employee searches is required publicly, managers try to hire people they know personally (e.g. due to knowledge about the competency and personal characteristics) or listen to recommendations (from colleagues and friends). In rare cases managers turn to Labour Offices to find an employee. This is influenced by formal regulations of the behaviour of both employer and employee. On the one hand, institutional development has contributed to a decline in the informal part of the economy, but on the other hand, the growth of institutional trust has been limited by labour market regulations, e.g. employment protection measures. Institutional development has changed intra-firm relationships between managers and employees, making them more regulated (e.g. employment contracts).

As for the use of sources of help, our analysis showed that in the early transition period managers relied mainly on personal trust, seeking help from persons they knew. Both family and business relations were used. This group includes more food-processing, small (10–49 employees) and older enterprises. Lack of alternatives may have been a problem for older enterprises which started up before business consultation firms could offer help. For younger enterprises the problem might have been a lack of information about consultation opportunities.

At the time of our investigation, i.e. in summer 2002, the managers relied above all on personal trust turning for help to employees and business partners; however, this is supported and substituted to quite a large extent by institutional trust where managers are ready to turn to persons and institutions who they may not know personally (business associations etc). This suggests that the business environment in Estonia has improved, encouraged by institutional development in this period and new opportunities for enterprises in finding foreign assistance.

Some differences can be found in requests for assistance, depending on whether managers belong to business associations or co-operate with other enterprises. The analysis shows that turning to more 'anonymous' sources (e.g. consultants, business agencies) prevails among the members of business associations, which obviously is possible thanks to contacts with the business network based on membership. Therefore, membership supports business relationships in the direction of strengthening institutional trust. Participation in co-operation networks increases the strength of personal trust between partners, but to a certain extent also promotes the development of institutional trust, as these enterprises are more open to new business relations and sources of information (e.g. business associations).

Differentiation of three forms of trust

Based on our survey analysis, it has been easy to distinguish between personal and institutional trust, that is whether managers are dealing with persons they know (incl. regular relations) or they can enter into transactions with only limited information about partners (i.e. anonymity), because there are legal safeguards and sanctions in case the relationship fails. However, it was more difficult to identify collective trust, which refers to group behaviour, i.e. it is based on shared norms and mutual business conventions (or maybe the role of collective trust is smaller

than other types of trust in business relationships). A good example is the cooperation of suppliers and their joining in a mutual convention against clients, who have not paid for goods on time. This kind of activity relies on collective trust, which helps to oust dishonest clients from the market and develop a more trustworthy environment. The cases of collective trust can be distinguished also in situations where the selection of partners or employees is based on third party recommendations. Another example is the enterprises' entry into the market after their establishment. In the case of enterprise's positive development, a change can be from being a "nobody" to having a reputation, where initially the enterprise can rely only on personal business relations (and personal trust) and after some time it may become well-known to more customers (collective trust). In transition economies, this development has been encouraged by the improvement of the institutional environment and economic stabilization. The survey analysis shows that the situations where managers rely on collective trust have changed since the beginning of the transition period.

When deciding on the type of agreement, entrepreneurs consider a number of criteria, of which all of them are estimated very highly by different enterprise groups. The most frequently mentioned were: previous experience with the firm, the reputation of the customer/supplier, the amount involved in the expected deal, guarantees with respect to delivery or payment failure and recommendations from a business partner. Therefore, enterprises rely first of all on personal trust, followed by collective trust and institutional trust. All criteria are estimated highly to some extent by entrepreneurs of the business service sector and small firms (10–49 employees). Differences in opinions between enterprises in different age groups are not so obvious. However, recommendations from business partner and guarantees with respect to delivery or payment failure are less frequently mentioned by younger firms, which can be explained by their status on the market.

If we evaluate the entrepreneurship environment on the basis of the role of trust used in supplier-customer relationships in the forms of agreements, then in customer relationships enterprises from the business service sector and small firms use institutional trust more often, and personal trust is more apparent in the trade sector, micro and older firms. In supplier relationships, institutional trust is more important in the trade sector and in small firms, whereas personal trust play more of a role for micro enterprises and older firms. In using sources of assistance, institutional trust or turning to more anonymous sources (agencies, associations) was more frequent in the trade and food processing sectors, which is explained by certain features of these sectors (e.g. resources, licenses). The most important sources of market information in most of the groups of enterprises were recommendations from customers and suppliers or enterprises relied on collective trust. Micro enterprises use personal contacts more often, small and older enterprises mass media, exhibitions, fairs and brochures, or they rely on institutional trust. When managers consider new business transactions they estimate existing business relations with customers and suppliers to be very important. This applies to all groups of enterprises, although there were small differences (e.g. less important in micro-firms). Thus, we can meet different roles of trust in business relations in different groups of enterprises, which are influenced by the particular conditions of the environment and sector-specific features.

Looking at the development of business relations, the above examples of enterprises' behaviour and the processes over time illustrate changes in the Estonian enterprise environment as well as changes in the role of trust in business relations. Because this development has seen the replacement of uncertainty with a more stable environment, this has encouraged the growth of institutional, and in some cases also collective, trust in business relations. This in turn allows the general conclusion that the development of an internal and external entrepreneurship environment in Estonia has been from lower-trust to higher-trust milieus. Although we have evaluated and provided examples of different levels of trust in different relations (evaluating them by the role of personal and institutional (or collective trust) trust), in order to better identify low-trust and high-trust milieus by sectors, size and other groups, we need further research to specify which factors influence changes in the level of trust. Further research into the dynamic devel-

opment of trust in business relationships would also enable a better assessment of the features of trust milieus and their changes in transition countries.

Summary

Estonia has experienced major changes in entrepreneurship, in people's attitudes and in the business relations environment in connection with the development of market relations since the transition period started. With the stabilization of the environment, trust relations have developed and changed in all their forms, while the improved formal institutions have started to promote development of business relations more toward stability and predictability. The survey results indicated that business relations are not very focused on one form of trust, but are based on all three types of trust (i.e. personal, collective and institutional), depending on the need to adapt to specific environmental conditions.

The development and changes in trust relations depend on many features of enterprises (size, age, sector, involvement of partners, membership and co-operation) and the progress of reform processes in society. In the early transition period, personal trust prevailed in business relationships. Alongside dynamic changes in business environment and institutional development in the country, the role of institutional trust has increased. A majority of the firms use more written contract as agreements, indicating the observance of fixed rules and norms and the wish to guarantee stability by enterprises. Managers value the creation of long-term relations. In intra-firm relations they also rely on institutional regulation and the development of democracy in management.

The new mechanisms of the regulatory framework in the firm have influenced changes in enterprises' strategies, which enables them to adapt to the external environment, especially in the cases where institutional regulations (legal, financial, etc) restrict the accomplishment of their objectives. The analysis of the survey results and case studies have helped to understand conditions in the entrepreneurship environment and processes that support the development of trust in both inter- and intra-firm relations.

Short table overview of case studies

#1	Retail trade company, micro-business, founded in 1996. Currently employs 9 persons. Interviewee: managing director, female in her 30s.
#2	Food processing and wholesale trade company, small business, founded in 1992. Currently employs 14 persons. Interviewee: managing director, male in his 50s.
#3	Wholesale trade company, small business, founded in 1993. Currently employs 46 persons. Interviewee: managing director (co-owner), female in her 50s
#4	Business services company, small business, restructured from another enterprise in 1990. Currently employs 22 persons. Interviewee: managing director, male (co-owner) in his 50s.
#5	Business services company, micro business, founded in 2001. Currently the firm consists of 2 owners – sister and brother. Interviewee: owner/manager, female in her 30s.
#6	Wholesale trade company, micro business, daughter firm founded in 2002. Currently employs 9 persons. Interviewee: managing director, female in her 30s.
#7	Food processing company, small business, restructured from another firm in 1994. Currently employs 15 persons. Interviewee: managing director, female in her 60s.
#8	Wholesale company, micro business, newly established in 2001. Currently employs 9 people. Interviewee: owner/manager, male in his 50s.
#9	Food processing company, micro business, bought in 1999. Currently employs 9 persons. Interviewee: owner/manager, male on his 60s.
#10	Business services company, micro business, founded in 1994. Currently employs 3 persons. Interviewee: owner/manager, female in her 50s.

Trust and Entrepreneurial Behaviour in Russia

The report is based on desk research as well as on the following empirical research carried out in 2002–2003:

- An empirical survey of 400 small entrepreneurs in 4 Russian regions (100 entrepreneurs in each of the regions: Moscow, Nishny Novgorod, Voronesh and Kaluga);
- 30 semi-formalised interviews with entrepreneurs, most of whom were also included in the survey, to prepare a series of case studies in 3 regions (Moscow, Kaluga and Nishny Novgorod – see Appendix 1);
- 12 interviews with policy makers and representatives of Small and Medium Enterprises (SME), state and public support infrastructure institutions, representing both federal and regional bodies.

Selection of Regions

The following regions were chosen for the empirical surveys:

- Moscow city
- Nishny Novgorod oblast
- Kaluga oblast (Perm or Vologda would have been possible alternatives)¹
- Voronesh oblast (being not only a industrial centre, but also the capital of one of the Black Earth Oblasts with highly developed agriculture)

According to the “Ekspert – RA” agency’s² regional investment risk rating, the above regions belong to the following typical groups: (1A) maximum potential – minimal risk (Moscow, the single region in this group); (2B) medium potential – medium risk (Nishny Novgorod and Perm); (3B1) lower potential – moderate risk (Vologda, Kaluga, Voronesh).

All groups *below* a rating of 3B1 are characterised by a low level and a very moderate tempo of transition and by primitive development in the market economy and its institutions. It would thus be a rather confusing matter to investigate the *entrepreneurial* networks of these groups because of the absence of more or less stable entrepreneurship, which is more or less independent from regional and local bodies. High- and low-trust networks exist in these areas; however, they are founded on non-entrepreneurial behaviour patterns.

The absence of regions belonging to such groups as 2A (medium potential – minimal risk; the only region in this group is Belgorod), 3A (low potential – minimal risk, the one region being Novgorod) and 1B (St.-Petersburg, Moscow oblast, Sverdlovsk oblast, Khanty-Mansy autonomous okrug) can be explained as follows: because the number of regions in these groups is – unlike 2B and 3B1 – rather small, they are not representative for Russia.

Moscow, being also the only representative of the group 1A, is a special case: ca. 25% of all Russian SMEs and up to 80% of the finance capital volume are concentrated in the capital city.

In order to compare the environmental influence on the attitude of respondents to certain key questions, about one third of the sample from Nishny Novgorod region was taken from entrepreneurs in the second big city of the Oblast, Dzershinsk. (We assumed that there is a difference between Moscow as the capital city, with ca. 25% of all Russian SMEs, and the main regional cities, as well as between the latter and local centres and small towns, where the environment is still dominated by informal relations and dependencies).

¹ The final decision was made on the basis of recommendations of local sociological groups.

² For more details see: Ekspert 2001, No. 41, 5. November, pp. 97–128.

Profiles of the Selected Regions

Moscow city, with its 10.5 million inhabitants (according to the first estimations made after the 2002 population census³), has the status of a “subject” of the Russian Federation. The capital is the hub of the country’s economic life (with more than 80% of the entire capital turnover of Russia being concentrated in the city).

Moscow is the biggest city in the country; it plays a significant role in the financial, industrial, cultural and scientific life of Russia. Moscow produced ca. 12% of Russian GDP in 2001, and accounted for ca. 27% of the country’s retail trade, whereas industrial production amounted to ca. 7% and investments ca. 12,5%.

Moscow belongs to the highest group of regions (1A) with maximal potential and minimal risk according to the investment climate rating of Russian regions conducted by the “Ekspert-RA” agency.⁴

The private sector is well-developed, as are SMEs: there are approximately 180,000 SMEs, which represent about one third of all registered businesses in Moscow. Moreover, nearly 25% of all registered SMEs in Russia are concentrated within the borders of the metropolis.

The structure of Moscow’s small business environment is somewhat different from that in the country as a whole – B2B as well as innovative SMEs are developed to a higher degree in Moscow.

Nishny Novgorod Oblast on the Volga River, with its ca. 3.633 million inhabitants (of whom 1.364 million live in Nishny Novgorod itself), is one of the old industrial regions. The predominant industrial branches are the engineering, food, chemical and petrochemical industries. The oblast is one of the centres of the military-industrial complex. From the 18th to the beginning of the 20th century it was one of the main centres of wholesale trade of the country.

The region’s share of Russian GDP totals about 2.5%, of retail trade ca. 2%, of industrial production ca. 3% and investments amount to ca. 2% of the country’s total.

Nishny Novgorod belongs to the 2B group of (at present) 13 regions with medium potential and moderate risk. From being the focus for the activities of Western advisers and firms at the initial stage of reforms, the region has drifted to a middle rank since the mid-1990s for several (mostly political) reasons. However, the ranking of the oblast moved up between 2000–2001 and 2001–2002 by one place (from place 9 to place 8).⁵

The number of SMEs totalled 14,860, or approximately one third of all registered businesses in the region.

Voronezh Oblast in the so-called Black Earth region in the southern part of the European part of the country has 2.437 million inhabitants (ca. 1 million in Voronezh). Such highly developed industries as electric, energetic, engineering, metallurgical, food, chemical and petrochemical industries are concentrated in the oblast. It is one of the former centres of the military-industrial complex of the USSR (aeronautics, TV and optics etc.). Voronezh Oblast is also one of the main agricultural regions of Russia.

The region accounts for ca. 1% of Russia’s GDP, for ca. 1% of the country’s retail trade, ca. 1.1% of industrial production, ca. 0.8% of investments, but ca. 2.3% of the country’s total industrial production.

Voronezh belongs to the 3B1 group (24 regions), which includes oblasts and republics with a below-medium potential and moderate risk. The reasons for this are more or less political: the “mild” opposition of the regional political elite (strong influence of the Communist and Agrar-

³ All other data – according to previous statistics of the Goskomstat as to beginning of 2001 Rossiya v cifrakh. Moscow: Goskomstat, 2001, pp.34–38.

⁴ Ekspert, December, 2, 2002, pp. 94 (Russian).

⁵ Ibid., p. 102.

ian parties) to reforms and the “discrimination” against Western investors. For example, Phillips was forced to withdraw from a project which was to substantially modernise a former state-run TV plant in Voronesh.

The number of SMEs totalled 10,320, or about one third of the total number of legal entities operating in the region.

Kaluga Oblast is one of the regions closest to the big Moscow region. It has ca. 1.069 million inhabitants (345.000 in Kaluga city itself). It is an industrial-agrarian region with highly developed industries in the engineering, metallurgical, energy and construction materials production sectors.

The region’s share of Russian GDP, as well as of industrial production and retail, amounted to approximately 0.5%, of agricultural production to 0.9% and of investments to 0.4%.

Kaluga Oblast has the same ranking as Voronesh. However, it is one of the most dynamic regions as far as investment potential is concerned: its ranking moved up from place 45 in 2000–2001 to place 42 in 2001–2002.⁶

The number of SMEs totalled 6,850, or ca. 40% of registered legal entities in the Oblast.

Sectors

According to a decision of the project team, the sample was designed to include the three sectors where the SMEs in all the surveyed countries are represented the most (i.e., business services, food industry and trade).

The sample of entrepreneurs was designed to include ca. one third of entrepreneurs active in trade, one third in food industry and one third in business services. Moreover, we wanted to include equal numbers of enterprises of varying ages – start-ups, young, mature and old businesses.

However, the sectoral quota could not be fulfilled in each region. First, the characteristic feature of Russian SMEs is “multi-functionality”, whereby most of them combine several activities to ensure a steady turnover despite reduced demand in any single area. Second, it was especially difficult to find companies acting only or mainly in business oriented services in provincial cities; most of those were engaged (to a substantially greater degree) in trade and personally oriented services as well.

In general, the intention was to achieve an equal sectoral distribution within the sample between food industry, trade and business services. However, the actual sample structure was adjusted in favour of a higher representation of business services and especially trade, following the actual structure of small business in the surveyed regions (Table 1).

⁶ See *ibid.*, p. 103.

Table 1: What are the main activities that the firm is engaged in? Give up to three, starting with the main one. (in %)

Food industry	25.8
Trade	41.0
Business services	33.3

When preparing the sample structure on the basis of regional statistics for each of the surveyed regions, especially in Voronezh, local interviewers were forced to increase the number of trade firms, and to decrease the share of companies active in the food industry. In this agricultural region, medium-sized and big enterprises dominate the food industry.

Survey Report

Profile of Surveyed Enterprises

Age and Size

More than one third of the sample is comprised of start-ups and young firms. The most interesting group, however, are mature firms – among them there are a significant number of enterprises which started their business activities on the eve of the 1998 crisis, or some months after this crisis (Table 2).

Table 2: When did the enterprise commence trading? (in %)

Start-up (up to 1 year, 12 months)	10.5
Young (more than 1 year – 2.5 year, 13–30 months)	24.5
Mature (more than 2.5 – 5.5 years, 31–66 months)	28.8
Old (more than 5.5 years/66 months)	36.3

Micro firms (up to 9 employees) predominated among start-ups and young SMEs; among the mature and old SMEs, however, there were slightly more small firms (10–49 employees). Despite the fact that the sample is not representative, it is an indirect indicator that micro firms have a somewhat shorter lifespan than small enterprises. Cross cuts show a steadily diminishing number of micro firms in the sample and an increasing number of small enterprises.

The fact that there is only one start-up firm in the Kaluga sample is, again, an indirect indicator of the fact that the intensity of start-up activities is much lower in this region, compared not only with Moscow, but also with Nishny Novgorod, and even with the neighbouring Voronezh region.

There were more small enterprises than micro firms in the sample (Table 3). Because most micro firms are usually individuals, and interpersonal trust relations play a much higher role, only a small percentage of micro firms was included in the sample. Hence it was a big problem, especially outside Moscow, to find micro firms which were *legal* entity especially in Voronezh). On the other hand, in Moscow micro firms constituted more than half the sample.

Table 3: Do you have employees, or is there no-one working for your firm apart from yourself? If yes, what is the total number of workers employed in your enterprise at the present time (i.e. full time and part-time; temporary/contract staff as well as permanent staff)?

Micro enterprise (1–9 employees)	45.5%
Small enterprise (10–49 employees)	54.5%

Status at Start and Ownership

The overwhelming majority of firms were established after the beginning of market reforms in Russia (Table 4); the share of those which were *bought* is relatively low (exception – Nishny Novgorod, 13% of bought firms, start-ups – ca. 12%). It must be stressed that the selling and buying of small businesses is still not a common practice in Russia – hence, the problems associated with such a transaction.

The number of *newly established* firms was especially high in Voronezh (more than 90%), of *privatized* firms in Nishny Novgorod and of *restructured* firms in Moscow (19%).

Table 4: Upon inception, was your enterprise: (in %)

Newly established	75.8
Bought	6.0
Privatised	5.0
Restructured from another enterprise	13.0
Other (please specify)	0.3

According to Russian law, only enterprises with a certain number of employees (the number differs according to branch, but does not exceed 100 employees in the manufacturing industry) and with less than 25% of sources of capital other than SMEs, are defined as *small* ones. That is why the overwhelming majority of the sample is comprised entirely of private enterprises. The absence of any foreign firms and joint ventures in this sector is a fact: the well known macro-economic as well as geographical and socio-cultural specifics of Russia – still a, to a large extent, “closed” economy – explain this fact (Table 5).

Table 5: Which of the following best describes the ownership of your business? (in %)

Entirely private	93.8
Mixed state/municipal and private	3.0
Joint venture	1.0
Collective	1.5
Foreign	0.0
Other (please specify)	0.8

Profile of Owners/Managers/Respondents

Sex and age

There are more than 60% men and ca. 40% women in the sample. The percentage of men is higher among owners of small enterprises (10–49 employees), mature firms, service SMEs and in Kaluga; the percentage of women is larger in micro enterprises, among young firms, trading companies and in Moscow.

The age structure of the sample is as follows (Table 6):

Table 6: What is your age group? (in %)

under 20	0.3
20–29	18.3
30–39	35.3
40–49	30.0
50–59	16.0
60+	0.3

Moscow entrepreneurs are somewhat younger, and respondents in Nishny Novgorod somewhat older, than the sample average. Persons of middle age were represented more among owners of trade firms, and the older age groups in services. A distinct tendency for younger age groups to predominate among start-ups and young enterprises, and for the older and oldest age groups to do so among mature and old SMEs was observed.

Education

Official statistics, as well as the data of several sociological studies, show that Russian small entrepreneurs have attained a relatively high level of education. (Table 7):

Table 7: What is your highest level of education? (in %)

Primary school	0.0
Secondary school	7.5
Secondary vocational school	15.0
University level	76.5
Other (please specify)	1.0

Analysis of cross cuts showed, however, that there was one single group with a high share of *primary school* education in our sample: owners of food industry firms (18%). *Secondary school* education was present to a somewhat higher degree among entrepreneurs in Nishny Novgorod, the food industry (almost a quarter) and owners of young firms. The share of persons with a *higher school* education was higher among respondents in services (more than 90%), in Voronezh and in small enterprises.

Professional background

Up to 40% of entrepreneurs in the sample already had previous experience in private business (Table 8): this is a remarkable difference to the early 1990s, when most of the beginners lacked any experience with commercial matters.

Table 8: Where did you work before you started your present business? (in %)

State production sphere	20.8
State non-production sphere	24.5
Private business of which you were not an owner	33.3
Private business of which you were an owner	11.8
Education	6.3
Unemployed	2.0
Other (please specify)	1.5

With regards to previous employment, the sample is divided nearly equally between state and private sectors. There are however some regional and sectoral variations: representatives of the *state production sector* were encountered more often among Nishny Novgorod entrepreneurs and owners of old firms; of the *state non-production sector* among Voronezh respondents and owners of old firms; former *employees of private firms* among start-ups (50%) and Moscow entrepreneurs; former *owners of private firms* among start-ups, food industry SMEs and Moscow entrepreneurs.

Table 9: Did you have management experience before starting your own business? (in %)

No	40.5
Yes	59.5

Ca. 60 % of the sample had some management experience (Table 9). Among owners of services SMEs and old firms as well as Moscow and Voronezh entrepreneurs there were more persons with experience than the sample average (nearly two thirds of these groups). Respondents from Nishny Novgorod and in trade were less experienced.

However, about one third of entrepreneurs had managerial experience in private enterprises before starting their own business (Table 10), another third of them had acquired such experience in the state sector.

Table 10: If yes, in what type of organisation? (in %)

State enterprise	20.5
State institution	7.3
Private enterprise	29.8
Foreign company	0.5
NGO	0.8
Other (please specify)	0.8
Not applicable	40.5

There were more representatives of the state sector (enterprises and institutions) than in the sample average in Kaluga, services and among owners of old SMEs; more representatives of the private sector in Moscow, in the food industry and especially among start-ups (50%!). Thus, *managerial experience in the private sector is to a certain extent a precondition for the social transfer to an entrepreneurial niche.*

Business development in 2001 and 2002

Changes in the number of employees, business performance and in sales indicate the business development of enterprises we surveyed.

The number of SMEs which increased or did not change the number of employees was considerable (Table 11); this is an indirect indicator of a certain stability and even “prosperity”.

The number of employees rose during the last year especially in Kaluga (60%), whereas in Moscow and Nishny Novgorod the share of such expanding firms was lower (29–30%); almost 57% small enterprises mentioned a rise in the number of employees, unlike micro firms, of which only 17% increased their staff.

Table 11: Comparing the number of employees today with 12 months ago, is it :(in %)

Higher	39.0
About the same	43.0
Lower	7.5
Not applicable	10.5

The interviewed entrepreneurs expressed more satisfaction with sales and personal goals whereas the profit satisfaction rates were somewhat lower (Table 12).

There are differences between regions in the satisfaction level with business performance in 2001: as for the *level of sales* and *profits*, more Moscow firms and small enterprises and a smaller percentage of Kaluga, micro firms and start-ups were satisfied. The older the firm, the higher the satisfaction level. The same can be said for *personal goals*, with the only difference being that there was a lower percentage of satisfied owners in the food industry, and a higher percentage among owners of service-oriented firms.

Table 12: To what extent were you satisfied with the performance of the business in 2001 in relation to each of the following?

	not satisfied	partly satisfied	satisfied	don't know	not applicable
Level of sales	19.5	62.8	16.0	1.0	0.8
Level of profits	28.8	57.3	12.0	1.3	0.8
Personal goals (please specify)	14.0	63.3	16.3	5.8	0.8

Sales (Table 13) were actually lower than in the previous year for only approximately half of those who were not satisfied with the sales level. This is another indicator of a growing economy. In particular, there was a higher than average share of pessimistic firms in Kaluga (77%), and among owners of small enterprises.

Table 13: Comparing the level of sales in 2001 with 2000, were they: (in %)

Higher	40.8
About the same	35.8
Lower	10.8
Don't know	2.3
Not applicable	10.5

In general, the surveyed entrepreneurs enjoyed stable or even growing business in 2001–2002, which were years of high growth levels of the Russian economy as a whole.

The role of and trust in business partners

It is evident that in a transitional economy with few opportunities to borrow initial capital and little experience in business etc., an important feature of entrepreneurial behaviour is the desire to 'protect' oneself by establishing a firm jointly with partners. However, *contrary to our assumptions, more than two thirds of interviewed entrepreneurs have no partners in their firm*; the most common role of partners in other firms is the contribution of capital, know-how and technology (Table 14).

Table 14: If you have business partners involved in the firm, please identify their role. You may give up to 3 answers. (in %)

Contribute capital	35.0
Contribute know-how	21.8
Contribute technology	16.8
Involved in management	15.3
Other (please specify)	1.5

Partners in Moscow, start-ups and food industry firms more often *contribute capital*; partners in services: *know-how* (2 times more often than in the sample on average); in Voronezh more partners than the sample average are *involved in management*.

For nearly 40% of surveyed entrepreneurs, trust plays an important or very important role when making the decision to establish a firm jointly with other person(s); however, a larger share, *up to half of the surveyed entrepreneurs, regarded this question as irrelevant* (Table 15). Taking into consideration the above mentioned fact that only ca. one third of entrepreneurs in the survey had partners, we have to conclude that *more than three quarters of entrepreneurs we surveyed had no need for trust based relations when establishing their firms*.

The role of trust is somewhat higher in Kaluga, in services as well as in small enterprises (10–49 employees). On the other hand, it plays a lesser role in Moscow and in old firms.

Table 15: Please assess the importance of trust in your relationship with your business partners on a scale from 1 = very important to 5= of no importance. (in %)

1	31.5
2	6.8
3	7.5
4	4.0
5	3.0
Not applicable	47.3

Characteristics of the Market Served

Geographical Distribution of Market Presence

The firms surveyed predominantly served local markets; there were no significant diversions in the distribution of shares of turnover per market served compared to the sample average; changes in turnover per market served compared to the previous year were not remarkable either – about one half of respondents mentioned that there were no changes in shares of different types of markets served by their firms. (Tables 16 a–c)

Table 16a: Which markets do you serve?

Location	Which markets?
Oblast/region in which the business is located	98.0%
National market outside oblast/region	26.5%
Foreign markets in NIS, Baltic states, CEE	4.8%
Foreign markets in Western Europe and Western highly developed countries	2.0%
Foreign markets in other countries	2.0%

Table 16b: Please indicate the approximate share of turnover (in %) in the different markets in 2001.

Location	Share of turnover		
	1–50	100	not applicable
Oblast/region in which the business is located		72.3%	
National market outside oblast/region	20.3%		73.8%
Foreign markets in NIS, Baltic states, CEE			95.3%
Foreign markets in Western Europe and Western highly developed countries			98.0%
Foreign markets in other countries			98.0%

Table 16c: Did this change in comparison with the previous year (2001–2000)?

Location	Changes 2001–2000 (in %)				
	no changes	increased	decreased	don't know	not applicable
Oblast/region in which the business is located	48.3	30.8	7.0	1.0	13.0
National market outside oblast/region	10.8	8.3	3.5	1.0	76.5
Foreign markets in NIS, Baltic states, CEE	2.3	1.5	0.8		95.5
Foreign markets in Western Europe and Western highly developed countries	0.3	1.3	0.5		98.0
Foreign markets in other countries	1.0	0.8	0.3		98.8

The variation in the orientation of local markets among different sectors, age and size groups of SMEs is very small; only Moscow SMEs are somewhat more oriented towards markets outside their own region (5% are exclusively active in markets outside Moscow). Only in Kaluga did SMEs often (64%) state that the orientation towards the local area increased in 2001 compared with 2000. In all other regions, as well as in each of the groups we analysed (sector, size, age), ca. one half of them did not report any changes.

With regards to national markets, the markets in the NIS and Baltic states, and those in highly developed Western countries and other countries, the picture was the same: more often, firms in

Moscow, business services oriented SMEs and to some extent older bigger firms are engaged in transactions in such markets. Businesses in Kaluga, start-ups and young firms, trade and food industry, micro enterprises are clearly oriented towards local markets. The orientation towards national markets was higher (35% as compared to 30.8% on average) among business service enterprises.

Generally, surveyed entrepreneurs, unlike SMEs in Baltic States and small firms in EU countries, predominantly focussed their business strategies on local markets, due to the size of the country and lack of competence in international trade and competition.

The Role of the Shadow Economy

The extent to which the shadow economy is active directly affects the role and intensity of trust: in economies in which the share of the shadow economy is estimated to be very high, this can lead to a high level of distrust against 'unfamiliar' firms and makes firms dependent on the 'trust' of a network of old known firms, which are all active in the shadow economy. To estimate the share of the shadow economy in each sector, the following questions, dealing with the assumed reasons for engaging in shadow economic activities, were asked (Tables 17, 18).

Table 17: Could you estimate the share of business income which comes from shadow operations in enterprises like yours?

Zero	14.3%
Under 25%	12.3%
Under 50%	20.8%
Under 75%	31.3%
Under 100%	12.5%
100%	2.5%
Other	0.8%
Don't know	5.8%

Somewhat more than a quarter of surveyed entrepreneurs estimated the share of shadow income in SMEs like their own to be equal to zero or less than 25%; however, more than 43% assumed this share could be to 75% or even up to 100%, and 2.5% that all 100% of income came from shadow operations (!). Hence, it is possible that *up to half of surveyed firms are engaged in shadow transactions on a scale which is at least equal to their legal transactions!*

The regional distribution of answers showed that SMEs in Kaluga in particular estimated the share of shadow income to be very high (52% estimated it to be less than 75% and another 20% less than 100%), whilst in Nishny Novgorod the answers were the most positive: 32% were of the opinion that the share of shadow incomes equals zero, another 18% that it amounted to less than 25%. *Nota bene:* in Kaluga in particular entrepreneurs were convinced of the importance of trust in their relations with customers, contractors etc. (see more on this issue below). Hence, the initial assumption of the interdependence of the extent of activity in the shadow economy and the role of (personal) trust was proven to be true.

Besides, there were some differences in age groups: owners of young firms more often indicated higher shares of shadow incomes (37.8% estimated up to 75%, compared to 32.3% for the sample average, and 5% up to 100% in comparison with 2.5% for the sample average). Furthermore, trade SMEs mentioned a higher proportion of shares of shadow incomes in row 3 (up to 75%) and a lower proportion in row 2 (up to 50%) than SMEs in the food industry and especially the business oriented services.

Table 18: What are, in your opinion as an expert, the main reasons for operating in the shadow economy? Please name up to 3.

Avoid or reduce taxes (VAT, profit tax, etc.)	26.0%
Avoid or reduce obligatory social contributions	20.4%
Reduce attention of local authorities to success of firm	4.9%
Avoid attention of criminals	3.8%
Avoid local government regulations (e.g., with regard to health, environment)	3.8%
Avoid complicated licensing and/or registration procedures	4.6%
Other (please specify)	0.9%
Not applicable	35.4%
Don't know	0.2%

The two reasons most often mentioned for operating in shadow economy were: *to avoid or reduce taxes, and obligatory social contributions* (Table 18). All other possible reasons were named to a far lesser degree. However, the share of those who thought this question was not relevant was rather large (more than one third).

The first reason was more frequently named in Kaluga, the second in Nishny Novgorod. All other factors played no significant role.

Customer Base

The Russian economy at the beginning of the 21st century could be characterised as a 'customer's economy': many firms are competing to become a stable or regular supplier of several groups of customers. That is why the customer base of the entrepreneurs surveyed was of special interest (Table 19).

Table 19: Please indicate the main types of customer that you serve by placing ticks in the appropriate boxes in the column of the table below. (in %)

Types of Customer	not served by firm	served by firm
Final consumer	16.3	83.7
Distributor/wholesalers	77.3	22.7
Retail outlets	75.0	25.0
Private firms	53.3	46.7
State owned firms	73.8	26.2
Other (please specify)	99.0	1.0

The main types of customer served by the entrepreneurs surveyed were *final consumers* and *private firms*. The orientation towards final consumers was more intensive among Moscow and Voronezh firms, old SMEs; towards private firms among business oriented firms, SMEs in Kaluga, bigger firms and young SMEs.

The state as well as state owned firms are no longer interesting customers for the entrepreneurs surveyed (unlike, perhaps, some big firms).

The customer base of the SMEs surveyed is wide enough: an average firm had about 165 customers, and there were trading SMEs that exceeded this number (Table 20).

Table 20: Approximately how many customers do you serve? Please give the number.

Minimum	1
Maximum	3500
Mean	165.47
Valid	310

The *median* number of customers is higher among traders (50), in Kaluga (50), among mature and old SMEs, among SMEs with 10–49 employees (40 customers in each of these groups). It is smaller among young SMEs and Voronezh firms (20 customers in each of these groups), among service oriented SMEs (23) and micro enterprises (30).

Table 21: What percentage of your customers would you define as regular customers?

	52.5%
Don't know	4.8%

Interestingly, more than half of the customers were described as regular customers (Table 21): taking the participation of traders in the survey into consideration, the conclusion is that the customer base of most of the firms surveyed is rather stable and not growing; hence, the role of reciprocal trust should be especially high.

The share of regular customers is somewhat higher in Moscow, among services oriented firms, start-ups and young SMEs.

Supplier Base

Unlike the number of customers, the number of suppliers was rather small and a large percentage of them are regular suppliers (Tables 22, 23). This means that the entrepreneurs surveyed are satisfied with the amount, terms and quality of requested goods and services and do not look for alternative sources. On the other hand, they are perhaps interested in remaining within a functioning circle of suppliers because it offers opportunities to obtain supplies cheaper or according to more convenient payment schemes (this supposition was proved correct during the in-depth interviews with entrepreneurs in Russian cities).

Table 22: Approximately how many suppliers do you have? Please give the number.

Minimum	0
Maximum	200
Mean	13.38
Valid	386

Table 23: Which % of your suppliers do you use regularly?

Minimum	1
Maximum	100
Mean	78.15
Valid	359

The *median* number of suppliers is bigger among Kaluga firms, old SMEs, firms with 10–49 employees (10 suppliers in each of these groups) and in food industry (8). It is smaller among

Moscow SMEs, start-ups, micro enterprises and service oriented SMEs (5 suppliers in each of these groups); however, up to 100 % of them are regular suppliers for Moscow firms and young SMEs, and 90% for traders and micro enterprises.

Sources and channels for marketing information

The role of trust is important when a SME is looking for new markets or clients. Whom could an entrepreneur trust when gaining information and establishing new contacts (Table 24)?

Table 24: What methods do you use to increase the sales of your products/services and/or to gain customers? Please tick below as appropriate. (in %)

	No	Yes
None	90.8	9.3
word of mouth via family & friends	61.0	39.0
recommendations from customers and suppliers	34.5	65.5
advertising in mass media	44.5	55.5
brochures, flyers, etc.	69.0	31.0
Exhibitions, trade fairs	76.0	24.0
Other: please specify	90.3	9.8

The three most popular methods used to increase sales and to gain customers are recommendations from already established customers and suppliers, advertising in mass media and word of mouth via family and friends. Meanwhile, the share of those who never use the latter form is much bigger (61% vs. 39%), so *there are in fact only two widespread methods of increasing sales – recommendations (personal trust) and advertising in the mass media (collective trust).*

Recommendations from already established *customers and suppliers* are used most often by Moscow firms, business services oriented, mature firms and SMEs with 10–49 employees.

Advertising in mass media is used more often by bigger firms, firms in Kaluga and business services SMEs.

Family and friends are most often used to gain customers by young firms, SMEs in Nishny Novgorod and micro enterprises.

Almost the same picture is characteristic for the acquisition of information on the general development of domestic markets (Table 25): information on events in domestic markets is gathered primarily through contacts with colleagues from the same industry, established customers and suppliers, as well as from other businesses and specialist trade journals/literature. In fact, inter-personal contacts are predominantly used by entrepreneurs in this area.

It should be stressed that the role of institutions established to provide special information on markets and economic development etc. (exhibitions, consultants etc.) is rather small. This is a consequence of the low relevance of the information for special business needs (exhibitions and trade fairs), the high prices of services (active market research, consultants) or a low level of trust (business associations, chambers of commerce etc.), as some of the in-depth interviews with entrepreneurs in Kaluga, Nishny Novgorod and Moscow showed.

Table 25: If you need information about what is happening in domestic markets, how do you obtain it? Indicate up to 3 answers in each case. (in %)

Source of information	Domestic
From existing customers and suppliers	14.6
From employees	7.6
Informally from other businesses	12.3
From colleagues in the same industry	18.0
From trade journals/other specialist literature	12.3
From the general press/media	10.0
Active market research	3.4
From a consultant, business support agency	0.9
From business associations, chambers of commerce	0.8
From trade fairs/exhibitions	6.4
Other (please specify)	1.7
Not applicable	10.8
Don't know	1.3

Information obtained from colleagues in the same industry was most often indicated by one third of business services SMEs, by young firms, by SMEs in Kaluga and Voronezh; *information from existing customers and suppliers* by the food industry, Moscow and Nishny Novgorod firms and start-ups; *informally received information from other businesses* by start ups and young enterprises, business services SMEs and businesses in Kaluga and Voronezh and *information from trade journals/literature* by business services SMEs, Nishny Novgorod firms.

Customer-Supplier Relationships and the Role of Trust

Criteria for New Business Deals

Taking into consideration the peculiarities of the transition in Russia, it was expected that familiarity with a new partner and/or recommendations of already established partners or relatives or common friends would be an obligatory precondition for building a defence, based on trust, against commercial risks, rather than formal preconditions (such as good business plan or guarantees) or legal considerations. However, this observation was only partly true (Table 26); in fact, *the most important preconditions were the expected profit, the experience of the firm in this kind of deal* as well as *the advance payment*. The three least important were the legal status of the partner (in fact, the Russian commercial law and, even more important, enforcing these laws, is still treated as a weak security mechanism in case of non-payment etc. even if the partner has the legal status of an incorporated company), the familiarity with a new partner⁷ and a good business plan (which is needed only in a few cases when the deal is financed by the bank, and not from the firm's own budget).

Hence, 'experience in this kind of deal' and advance payment are forms of self-protection which usually play a much bigger role than any forms of collective or institutional trust.

⁷ This does seem to contradict statements of Table 27.

Table 26: If you prepare a new business deal, what aspects are relevant for your decision making? Please rate each factor on the following scale. (in %)

Factors	Most important	Also important	Not important	Don't know	Not applicable
Expected profit	63.4	29.6	1.5	3.9	1.5
Experience of your firm in this kind of deal	29.6	49.8	11.5	7.6	1.5
A good business plan	10.6	31.7	27.8	14.2	15.7
Guarantees against failure of delivery or payment	17.2	44.7	14.2	9.4	14.5
A recommendation from your bank	1.2	12.4	24.5	19.0	42.9
Recommendations from your regular commercial partners	6.0	48.0	18.4	13.6	13.9
Legal status of new partner	3.3	15.4	46.2	18.4	16.6
Advance payment	21.1	37.5	21.8	8.2	11.8
Familiarity with new partner	6.3	41.4	32.0	11.2	9.1
Other (please specify)	0.3	0.3	0	0	99.4

The analysis of the sample showed that when deciding new business deals the *expected profit* is more important for SMEs in Voronezh region and start-ups and less important for SMEs in Kaluga. The *experience of the firm in this kind of deal* is more important in Voronezh, for business services and young firms, but less important for companies in the food industry as well as mature and old firms. The *advance payment* is most important in the huge capital of Russia (where it plays a substitute role for trust, which is more important in smaller business communities) and relatively unimportant in Kaluga. Furthermore, it is more important for a certain percentage of start-ups (perhaps because these firms are more restricted in their financial abilities), but less important for a considerable number of those start-ups which benefit from their social and business networks. A *good business plan* is more important for start-ups and business services SMEs, as well as for bigger SMEs (10 to 49 employees), but less important in the food industry. *Guarantees against failure of delivery or payment* are more important in larger cities (Moscow, Nishny Novgorod) and less important for a relatively small Oblast capital city (Kaluga); moreover, guarantees are less important for a considerable number of start-ups. *Recommendations from regular commercial partners* are more important for a few business services SMEs, on the other hand, for those in the food industry it is rather less important; besides, the older the firm is, the less important is the role of established partners' advice in its decisions on new deals. The *legal status of a potential new partner* is somewhat more important for firms in business services and mature SMEs. *Familiarity with a new partner* is more important in Moscow and less important in Kaluga (perhaps because it is much easier to collect informal references in a smaller town than in Moscow); moreover, it is more important for starting firms, in business services and micro firms. *Recommendations by the home bank* were rather less important, because most of the Russian SMEs use the banks only for transferring money, not as advice and business supporting institutions.

Table 27: Which of the following persons/groups do you prefer in business transactions? Please name up to 3 in order of priority. (in %)

	1 st priority v210	2 nd and 3 priority v211+v212
No preference	25.1	-
People from my native region	16.0	20.5
People of my ethnicity	2.4	8.8
People of my religion	0.0	2.7
Members of the same business association, chamber	0.6	7.6
Established business partners	49.2	16.0
Friends	4.8	35.0
Family members	1.5	19.3
Other (please specify) (=6)	0.3	0.3

Comparing the above results with Tables 27 and 28, one can correct the claim that personal familiarity with a new partner plays a small role. The preferences in doing business transactions are as follows: *established business partners and people from the entrepreneur's native region are the persons/groups with whom entrepreneurs prefer to renew existing or to start new transactions.*

On the other hand, religion, membership in the same association or chamber (there are only a few Russian SMEs participating in such institutions) and ethnicity play no or almost no role in such a decision. This was an interesting result, because we assumed that ethnicity and religion play a much more important role, given the ethnic and religious problems caused by political factors (Chechnya etc.).

Another interesting fact was the negligible role of friends and relatives – the initial period of doing business within the circle of friends and family seems to be over.

When sorted by region, sector and age, we find that a larger share of firms in Voronezh, and trade and young firms have *no preferences*. Kaluga SMEs and old firms prefer *partners from their own region*. *People of the same ethnicity* (the least important factor in the sample) were somewhat more frequently mentioned by entrepreneurs in Kaluga. *Established business partners* were somewhat more frequently mentioned by the food industry; *friends* by entrepreneurs in Nishny Novgorod and, of course, by the start-ups. Family members and members of the same business association were mentioned very rarely; people of the same religion by nobody.

Taking the aggregate total of the second and third important priorities, the following results were of interest: entrepreneurs in Nishny Novgorod, and owners of food industry firms and start-ups more frequently prefer *partners from their own region*; those from Kaluga, and in the food industry prefer *people of the same ethnicity*; entrepreneurs from Kaluga and Nishny Novgorod and in start-ups prefer *established business partners*; *friends* – respondents from Moscow, the food industry and start-ups; *family members* – again, Moscow, the food industry and start-ups.

Table 28: When you consider new business transactions, what role do existing business relations with customers/suppliers play in your considerations? (in %)

as important as the business deal and contractual terms	57.0
more important than the business deal and contractual terms	16.8
less important than the business deal and contractual terms	26.3

Already existing business relations play an important role in the planning of new business transactions – for more than a half of the respondents it is as important as the business deal and contractual terms. A comparison shows that when planning new deals, existing business relations play *a more considerable role* in Nishny Novgorod and especially in Voronesh. Furthermore, these relations are more important for food industry and old SMEs. On the other hand, the importance of this factor is relatively small in Moscow and for trade firms; these relations are of moderate importance for start-ups (because of the lack of any “established” business ties).

Types of Agreement

Regulations and rules seem to be less important when doing business with well-known partners. However, the entrepreneurs surveyed preferred to sign written contracts with customers and, in particular, suppliers – oral agreements were used by only one third (Table 29).

Table 29: In which ways do you usually regulate your customer and supplier relations? Please tick below as appropriate. (in %)

Type of agreements	Customer	Supplier
No agreements	23.8	7.5
Oral agreements	36.5	33.5
Written contract	58.8	74.0
Other (please specify)		

Here, again, the role of existing contacts and the reputation of the possible partner played a key role in deciding which type of agreement to choose. However, it is to be stressed that according to Russian tax legislation *written* contracts are mandatory among legal entities; which is the reason why the results presented in Table 30 are to be viewed somewhat critically.

Table 30: According to which of the following criteria do you choose the type of agreement? Please tick below as appropriate. (in %)

Type of agreement	no	yes
Reputation of the customer/supplier	37.0	63.0
Recommendation from a business partner	55.0	45.0
Previous experiences with this firm	14.5	85.5
Value of the expected deal	34.5	65.5
Guarantees with respect to delivery or payment failure	48.5	51.5
Other (please specify)	98.2	1.8

The criteria usually preferred when choosing the type of agreement are as follows (the respondents could reply ‘yes’ or ‘no’): previous experience with the firm; the value of the expected deal; reputation of the customer/supplier.

Looking at the regional, age and sectoral groups, it is worth mentioning that *previous experience with the firm* is much more important for Kaluga SMEs and young firms and less important for Voronesh SMEs. The *value of the expected deal* is of more importance for Kaluga, mature firms and less important for Nishny Novgorod SMEs, start-ups and business services. *Reputation of the customer/supplier* is more important for Nishny Novgorod and Voronesh firms, and less so for SMEs in the food industry. *Guarantees* with respect to delivery or payment failure are more important for firms from Kaluga, in the food industry, and among bigger

and mature SMEs, but much less important for start-ups, , micro enterprises companies in Nishny Novgorod and in the business services. *Recommendations from business partners* are in fact considerably less important than the four factors mentioned above. However, younger firms answered more positively with regards to this factor. in Kaluga half of the respondents indicated that it is important for them.

Terms of Payment

Considering the state of the Russian legal system, terms of payment are a relevant criterion of trust/distrust between partners (Table 31). The two forms mainly used by respondents are cash and bank transfers; even short term credits with a duration of up to one month are used by only one third of them (in our opinion, the reason for this is not so much the lack of trust, but rather the simple absence of spare money).

Moreover, the fact that one-quarter of the SMEs surveyed usually extend credit to their partners for up to one week is significant: taking into consideration that SMEs often work under hard cash constraints, such a practice – in contrast to the practice of prepayment, which was widespread in the early 1990s – shows a higher level of commercial trust in present-day Russia. (see Table 32)

Table 31: What are the usual terms of payment you offer to your customers? Please tick below as appropriate. (in %)

Payment terms	no	yes
Cash on delivery	15.3	84.7
Bank transfer	40.3	59.7
Credit up to 1 week	75.8	24.2
Credit up to 1 month	87.5	12.5
Credit more than 1 month	93.8	6.2
Other (please specify)	97.3	2.8

Cash on delivery is especially widespread among Kaluga and young firms (in both groups nearly 90%) and food industry SMEs, but less so among business services and start-ups. *Bank transfers* are, on the contrary, a more common practice in business services, in bigger firms (10 to 49 employees) and in Nishny Novgorod.

On the other hand, credit for up to 1 week is used by 45% of entrepreneurs in Kaluga, and by more than a third of food industry SMEs; more than 1 month – by ca. 10% of old enterprises.

Table 32: If you extend credit to your customers, how important is trust for you in making this decision? Please assess on a scale from 1= very important to 5= of no importance. (in %)

1	22.3
2	3.0
3	3.3
4	0.8
5	2.8
Not applicable	68.0

More than two thirds of respondents never allow credit, but for the overwhelming majority of those who do so, trust is “very important” or “important” in making such a decision. This is especially the case for entrepreneurs in Kaluga (41%) and food industry SMEs.

Despite the fact that most suppliers are already established partners, and, accordingly, a high level of confidence in customers might be expected, suppliers use the same two methods of payment, cash on delivery and bank transfers (Table 33). They usually do not extend credit, in contrast to what one would expect in a ‘customers market’ (Table 34). Trading firms constitute a considerable part of the sample, and they usually prefer to pay in cash immediately after receipt of goods. This is however true only for this group of entrepreneurs. As regards for other sectors, especially the services and food industry, we would suggest that most suppliers belong to a group of a few larger firms with considerable turnovers, which would not be limited by cash constraints in extending credit to established customers. A possible conclusion might be that it is still lack of trust preventing them from using such a sales strategy. (cf. Tables 34, 35)

Table 33: What are the usual payment terms expected by your suppliers?

Please tick below as appropriate. (in %)

Payment terms	No	Yes	Not applicable
Cash on delivery	21.5	71.8	6.7
Bank transfer	29.5	63.8	6.7
Credit up to 1 week	60.0	33.3	6.7
Credit up to 1 month	73.0	20.3	6.7
Credit more than 1 month	84.0	9.3	6.7
Other (please specify)	90.8	2.5	6.7

Cash on delivery is the most widespread form of payment in Kaluga (up to 96%!), the food industry, young firms and micro enterprises; *bank transfers* among small firms with up to 49 employees, old firms, Kaluga and Voronesh SMEs; *credit for up to 1 week* among food industry firms, old firms; for *up to 1 month* among Moscow SMEs (37%); for *more than 1 month* among Moscow SMEs (19%).

Table 34: If your suppliers extend credit to you, how important is trust for them in making this decision? Please assess on a scale from 1= very important to 5= of no importance. (in %)

1	27.8
2	5.0
3	2.3
4	3.0
5	6.5
Not applicable	55.5

More than half of the respondents received no credit from their suppliers; among the remaining part more than 70% assessed the role of such credit as “very important” or “important”. It is very important especially for Kalugan SMEs and old firms, and rather unimportant for business service firms.

However, the entrepreneurs surveyed frequently used both commercial credit and mutual guarantees (Table 35). The former presupposes a certain level of trust; the second is a form of insti-

tutional security for transactions. This is an indirect sign of trust functioning to a certain extent, not only at the individual, but also at the institutional level (guarantees).

Table 35: How often do you use the following forms of transactions when dealing with regular suppliers and customers? Please tick below as appropriate.

	Often	Sometimes	Never	Don't know
Commercial credit (consignation)	20.5	28.0	47.3	4.3
Mutual guarantees	25.5	26.5	43.3	5.0
Payments to third parties which you make in favour of your partner, or your partner makes in your favour	1.5	24.5	67.5	6.5
Other (please specify)	0.8	0.5	0.0	98.7

Mutual guarantees are a more common practice in Nishny Novgorod (more than 40%) and in more than 30% of old firms, and relatively rare in Kaluga and young enterprises. *Commercial credit* is more often used by firms in Moscow and Nishny Novgorod and by mature firms, but relatively rarely in Kaluga, among start-ups and young firms, and in the business services. However, the role of trust in Kaluga is high: more than 40% “sometimes” *make payments to third parties on behalf of their partners*; besides, more than one third of mature enterprises are familiar with this practice.

Credit Transactions and the Role of Trust

Credits Received

Trust is a crucial (and often the sole) base for receiving so-called “love capital” – loans and/or donations from relatives and friends. This practice is very widespread among the entrepreneurs surveyed (Table 36).

Table 36: Have you ever received capital from any of the following sources? b) If yes, did you provide any collateral or security? Please tick as appropriate. (in %)

	a) received capital		b) collateral		no credit from source
	no	yes	no	yes	
Family	62.5	37.5	36.3	1.3	62.4
Friends	66.5	33.5	27.8	5.8	66.4
Employees	95.5	4.5	4.3	0.3	95.4
Customers	91.0	9.0	5.8	3.3	90.9
Suppliers	96.5	3.5	3.0	0.5	96.5
Business partners	65.3	34.7	22.3	12.5	65.2
Previous colleagues	92.3	7.7	6.8	1.0	92.2
Bank	80.0	20.0	7.5	12.5	80.0
State programs/donors	95.3	4.7	1.8	3.0	95.2
Other: please specify	96.8	3.2	2.8	0.5	96.7

Thus, more than one third of respondents have received capital from family, friends or business partners. Other sources – banks excluded – are negligible. The role of customers or suppliers is rather small – more than 90% of surveyed entrepreneurs never received credit from the latter. Family and friends grant the most favourable conditions for a credit, while credits from business partners and banks often have to be covered by collateral.

Respondents from Kaluga and Nishny Novgorod, firms in the food industry and trade, and from older and smaller SMEs more often than average mentioned *credits from family*, Kaluga and micro firms *credits from friends*. *Credits from business partners* were much more often received in Moscow (more than 45%) and much less often in Nishny Novgorod (only 18%). Larger SMEs, young and mature firms as well as enterprises in the food industry receive credits from business partners more often than the sample average.

Nota bene: it is not clear who these “business partners” are, however, it is obvious that only in a few cases are they suppliers or customers. It can only be supposed that for the most part they are informal lenders – “shadow bankers” with dubious background etc. – or firms with large cash turnovers (trade, services etc.).

For most categories of credit, the number of lenders who demanded any collateral or security was negligible. However, two categories, business partners and banks, use this form more often than average to secure their transactions. Thus, collateral and securities provided to *business partners* are used by more than half of the creditors in Voronezh, by old firms and in trade. Banks only grant credits to start-ups if they are covered by 100% collateral; they request collateral or security somewhat more often from bigger firms (two thirds in this category of SMEs) than from micro enterprises (perhaps because the value of credits in this case are much bigger than in the case of micro firms).

‘Love capital’ is desirable, especially for start-ups and micro firms, because in this case collateral is usually not necessary (Table 37). In cases where collateral was needed, it covered the entire loan much more often in Kaluga (30% of those who received credit), in the case of about one-quarter of old firms and relatively big SMEs, and somewhat more often in the case of food enterprises and trade firms.

Table 37: If you had to provide collateral, did it cover

The entire loan	18.3%
More than half of the value of the loan	5.8%
Less than half of the value of the loan	5.8%
Not applicable	70.3%

The role of trust was in fact crucial: nearly half of those who had to provide less than 100% security assess trust as “very important” or “important” (Table 38). This was especially true for Moscow entrepreneurs and food industry SMEs.

Table 38: In those cases where less than 100% security was provided, please assess the role of trust in the decision of the creditor to give you the loan, on a scale from 1=very important to 5=of no importance. (in %)

1	5.0
2	0.3
3	4.8
4	1.0
5	0.5
Not applicable	88.5

Credits Given

On the whole the role of relatives as debtors is rather small. The most favoured recipients of credits are employees; family members are only at 4th place, after friends and business partners (Table 39). These results show that certain patriarchal behaviour patterns still exist and are widespread among Russian small entrepreneurs: financial help to both employees and friends is accepted as a kind of social debt owed by businessmen/businesswomen.

Table 39: Have you ever lent money to persons from any of the following groups? (in %)

	No	Yes
Family)	79.5	20.5
Friends)	72.0	28.0
Employees	66.3	33.7
Customer (v58)	83.5	16.5
Supplier	80.5	19.5
Business partners	74.5	25.5
Previous colleagues	94.5	5.5
Other: please specify	99.8	0.2

Cross-sectional analysis shows that *family* members are more often recipients of credits in Kaluga, and food industry enterprises owners give credits to their relatives much more often (and two and a half times more often than owners of business services firms); moreover, it is a more frequent practice in micro firms. *Friends* receive credits more often in Kaluga and Nishny Novgorod, from the food industry and trade firms and from old SMEs. *Employees* benefit from such credits in more than half (!) of Kaluga firms, especially so in old SMEs, in bigger firms and in trade. *Business partners* are more often beneficiaries of such credits in Kaluga and Voronezh and relatively rarely in Moscow and Nishny Novgorod. Such a practice is relatively widespread in old SMEs, bigger firms (up to one third in each category). *Suppliers* are the favourite credit recipients of more than one third of Kaluga entrepreneurs and nearly one third of company owners in the food industry.

Governance of Credit Agreements

It is evident that not only the conditions, but also the regulation of credit, are rather informal in transactions with such groups as family and friends. On the other hand, transactions with banks are nearly always regulated by written contracts (Table 40). Meanwhile, it is interesting that the deals with business partners, as well as with customers and suppliers, belong to a borderline group between those transactions which are normally regulated in written form and those regulated by oral agreements, or not at all.

Table 40: How are your credit transactions (both receiving and giving credits) usually regulated, i.e. by what sort of agreement? (in %)

	no credit from/to source	no regulations	oral agreement	written contract
Family	55.9	14.8	29.0	0.3
Friends	55.0	7.5	35.5	2.0
Customer	76.4	3.0	7.3	13.3
Supplier	77.5	2.0	10.0	10.5
Business partners	55.5	6.5	14.5	23.5
Bank	80.0	1.5	-	18.5
State programs/donors	95.2	1.0	-	3.8
Other: please specify	57.8	30.5	9.0	2.8

Credits from *family* members are not regulated, or regulated only by an oral agreement, especially in Kaluga and Nishny Novgorod, whereas in Moscow and Voronezh it seems that there are no financial relations with the family in this form. More often such transactions remain unregulated (or are only orally regulated) by food industry SMEs and micro enterprises. The same holds true for credits from *friends* in Nishny Novgorod, the food industry, and from *business partners* in Kaluga (ca. one-quarter of all cases) and young firms.

The credit agreements with the most formal regulations are those with state programs/donors, banks and business partners; the least regulated credits are those with family and friends (Table 41). Between these two extremes lie credit agreements with customers, suppliers and former colleagues. The credit agreements with family members nearly all exclude any interest and collateral data, so they are in fact not credits, but subsidies.

Table 41: Which conditions are normally included in your credit agreements? Please fill in as appropriate. (in %)

	Amount	Maturity (when to pay)	Interest	Collateral	Default provision (what to do in case of non-payment)
Family	29.3	19.8	0.5	0.3	0.8
Friends	37.5	30.3	3.3	1.3	2.3
Customer	19.0	20.3	4.8	2.5	1.3
Supplier	18.5	20.3	2.8	1.3	1.0
Business partners	35.8	37.0	11.8	8.5	5.8
Previous colleagues	6.5	6.5	1.5	1.3	0.8
Bank	18.5	18.3	17.5	15.5	4.8
State programs/donors	3.8	3.5	3.5	3.5	0.8
Other: please specify	5.5	5.5	1.3	1.3	0.0

However, a comparison of the various cross-sections shows that there are many specific differences in credit agreement regulations. In Kaluga and Nishny Novgorod, maturity is included in

credit agreements with *family* members a lot less often than on average. In business services maturity is stipulated in almost all cases, whereas in other branches in 50% to 75% of all cases.

Credit agreements with *friends* that include maturity are rather rare in Nishny and Kaluga. Credit agreements of mature SMEs with *business partners* very rarely include concrete maturity data. It is worth mentioning here that even credit agreements with business partners foresee interest rates only in a quarter to a third of all cases – in fact this is not commercial money lending, but a sign of trust and solidarity.

Thus, the absence or shortage of bank financing in Russia is compensated to a great degree by access to funding from family, friends and business partners. From this point of view, social capital (networks, connections etc.) is an efficient substitute for a missing finance system in the SME sector. However, this very situation reflects negatively on the credit histories etc. of SMEs, preventing them from trying to obtain credits from formal institutions in the financial sector. Informal financing based on personal trust thus contradicts the urgent need of the whole economy for formal procedures and institutions able to finance SMEs based on collective trust networking.

Co-operation with Other Enterprises

Nature of Co-operation Relationships

The Russian SME sector is very young. The institutional environment is rather unstable. That is why networking in the form of co-operation is not very developed. More than two-thirds of respondents have no stable co-operation partners (Table 42).

Table 42: Do you co-operate with other businesses/entrepreneurs in ways other than selling to them or buying from them? (in %)

No	68.5
Yes	31.5

There are significant differences between regions: 57% co-operate in Kaluga against 18% in Voronezh; in addition, services SMEs, older and bigger firms have such partnerships more often.

Forms of co-operation, if they exist, are usually rather primitive, based on personal contacts and personal trust (Table 43). The most popular answers were: exchange of advice, of information and of technology; moreover, even such “primitive”, or, in the case of technology exchange, not so primitive forms of co-operation were not very widespread.

The answer *exchange of advice* was given twice as frequently as normal by Kaluga entrepreneurs, SMEs in services, and somewhat more frequently by bigger firms; *exchange of information* – 3 times more often in Kaluga; *exchange of technology* – 2 times more frequently in Kaluga.

The aggregate total of the second and third priorities shows that exchange of information and of advice are the most popular forms of co-operation. *Advice* is exchanged most frequently in Kaluga; *information* in Kaluga and by services SMEs; *technology* likewise in services; *joint production/services* are more widespread among firms in services and in Kaluga; *joint purchasing* of supplies etc. in Kaluga and among young firms; *joint training of employees* among young SMEs.

Table 43: If yes, in which ways do you co-operate? Please name up to 3 in order of priority and tick below as appropriate. (in %)

	1 st priority	2 nd and 3 rd priorities
Exchange of advice	10.8	10.8
Exchange of technology	4.0	6.3
Exchange of information (e.g., about markets)	6.8	12.8
Joint marketing or selling	2.8	4.3
Joint research	0.8	1.3
Joint training of employees	1.3	5.8
Joint production/services	2.8	7.3
Joint purchasing of supplies/services/raw materials	2.3	6.5
Joint security measures	0.3	2.6
Other (please specify)	0.0	0.3
Not applicable	68.5	-

Under the circumstances described above, it hardly comes as a surprise that almost one-third of all respondents had co-operation relationships had partners in the same regions where their firms were located (Table 44); this pertains to more than 94% of those who had some established forms of co-operation. The share of firms having co-operation partners outside Russia was relatively small, although they constitute ca. 17% of those who have co-operation partners.

Table 44: Where are your partners located? (in %)

Same oblast/region	29.3
Elsewhere in your country	12.3
In another NIS/CEE ⁸ country	2.0
In a Western country	2.3
Elsewhere	1.0
Not applicable	68.4

Kaluga firms and firms in the food industry and services are most “locally fixated” (more than half); firms from Kaluga and in the services industry more frequently have co-operation partners outside their home region in other regions of Russia, trade SMEs are surprisingly much less involved in co-operation ties, not only in their own regions, but also in the entire country.

The respondents themselves had mostly initiated the co-operation (Table 45).

⁸ NIS/CEE = New Independent States / Central and Eastern Europe

Table 45: Who initiated the co-operation? (in %)

You (entrepreneur)	23.8
Employees	3.0
Regular business partners (customer/supplier/other entrepreneurs)	15.5
Family and friends	1.8
Previous colleagues	1.5
Other (please specify)	0.0
Not applicable	68.4

Again, the differences between regions are significant: almost half of Kaluga SMEs were initiators of co-operation, whereas in Voronezh the share of such SMEs was the smallest – only 18%; other factors (perhaps with the exception of branch – service firms initiated co-operation somewhat more frequently than the sample average) did not play any role.

Value of Co-operation for Successful Business

Entrepreneurs who had established co-operation relationships were mostly aware of the importance of such networking (Table 46).

Table 46: Please assess the value of your co-operation for successful business. (in %)

Of no value	0.3
Of little value	13.0
Of high value	18.3
Not applicable	68.4

The value of co-operation was relatively high for ca. 57% of respondents who used some forms of co-operation. It was somewhat higher in Kaluga, service firms and for bigger SMEs, and lower in Voronezh and among trade firms.

Governance of Co-operation Relationships

Co-operation relationships are regulated differently than everyday deals (Table 47): two-thirds of entrepreneurs who have co-operation partners use only oral agreements, the remaining third uses written contracts. This is a consequence of the fact that such co-operation networks are usually established informally and concern information exchange etc. – taking this into consideration, it is clear that (and why) the role of trust is very high in co-operation relations in Russia (cf. Table 48).

Table 47: How do you regulate your co-operation? (in %)

oral agreements	29.5
written contract	15.3
not applicable	68.4

In particular, in Kaluga, and among the service industries and older SMEs, *oral* agreements are preferred. The *written* contractual form is, again, more frequently chosen by firms in Kaluga, the service industries, and older and bigger SMEs.

Table 48: In what circumstances are you happy to base co-operation on just a verbal agreement? (in %)

Business partner is a friend	18.0
Business partner is regular customer/supplier	21.0
Business partner belongs to the same business association	4.5
Business partner belongs to the same ethnic group	1.8
Business partner was recommended by people (friends, employees, others) who I trust	13.8
other (please specify)	0.5
not applicable	70.5

The three most common arguments for basing co-operation purely on an oral agreement are: the existence of established business ties (customer/supplier etc.), friendship (personal trust, too) and recommendations by trusted people. Generally, SMEs are very rarely members of any business association, so such a membership is a negligible factor for trust based co-operation regulations. *Contrary to assumptions, the sharing of a common ethnicity plays no role in trust based co-operation (networks) in Russia.*

In Kaluga, *friendship* is twice as significant as in the sample average; services and old SMEs indicated this argument more often. On the other hand, firms in Nishny Novgorod and Voronezh mentioned this factor half as often, and trade and young firms one and a half times less frequently. *Regular customer/supplier relations*, too, are a common reason in Kaluga (two times more frequent than on average), but not so significant in Nishny Novgorod and Voronezh. It was more frequently mentioned by older firms and SMEs in the service industries. On the other hand, co-operation undertaken by trade firms and start-ups (if they exist at all) rely on other forms of regulation. *Recommendations by people* whom the respondent knows was quoted by Kalugan SMEs three times as frequently as in the sample average, and in Voronezh 7 times less frequently; it was mentioned by services somewhat more frequently, and less frequently by owners of trade firms.

Intra-Organisational Relationships

In small businesses, relations based on trust are very important not only for external, but also for internal relations, i.e., for relations between managers and other employees. Usually, a small entrepreneur cannot organise a system of control scientifically or on an achievement based payment system, so it is very important to develop team spirit.

Relations with Managers

Somewhat more than half of entrepreneurs in our sample employed managers (Table 49).

Table 49: Are there any managers in your firm, besides yourself? (in %)

No	42.5
Yes	57.5

Managers were more often employed by bigger SMEs, firms in the food industry, older firms and companies in Kaluga; in comparison to small enterprises, very few micro firms hired managers.

Table 50: If yes, which areas are they responsible for? (in %)

Areas	No	Yes	Not applicable
Financial management	21.5	36.0	42.5
Personnel	26.8	30.8	42.5
Technology	33.3	24.3	42.5
Sales & Marketing	27.5	30.0	42.5
Strategic Development	40.5	17.0	42.5
Other (please specify)	55.5	2.0	42.5

It is to be stressed that the responsibilities of these managers were relatively broad. The most widespread responsibility was, of course, financial management (accounting, Table 50).

The cross-sectional analysis shows that *financial management* is more often transferred to hired managers in Kaluga and in small enterprises (10 to 49 employees); in addition, the older the firm, the greater the likelihood that a hired manager is responsible for financial matters. *Personnel management* is much more often the duty of a manager in small enterprises as opposed to micro firms and in old firms as opposed to start-ups and young SMEs. Technology is more often managed by a hired person in the food industry, Kaluga and in small enterprises; this is less often the case in micro firms, in trade and in Voronezh. *Sales and marketing* are conducted more often by managers in small enterprises, in old firms and start-ups and in the food industry; this is less often so in micro firms, in Kaluga, in service SMEs, in young and in mature firms. *Strategic management* is the task of managers somewhat more often in start-ups, in Moscow, in the food industry and in small enterprises, but less often in Kaluga, in mature firms and in micro enterprises.

Table 51: To what extent do you feel you can trust your managers to make decisions that are in the interest of your company? Please assess on a scale from 1=absolutely to 5=not at all.(in %)

1	18.3
2	18.8
3	13.5
4	3.8
5	1.5
Not applicable	42.5

Two-thirds of respondents who have managers in their employ can trust them absolutely or to a great extent (Table 51). The highest level of trust was indicated in Kaluga, in the food industry and in mature small enterprises; the lowest level in Moscow: there are perhaps more opportunities for the manager to use his inside knowledge and established networks of customers/suppliers to leave the firm and to build up his own business in a big capital such as Moscow.

Relations with Employees

Relations with employees are usually determined to a great extent by the methods and criteria used to select workers.

Table 52: Which criteria do you use to select your employees? Please give up to 3 answers in order of priority. (in %)

	1 st priority	2 nd and 3 rd priorities
I know future employees	16.5	16.5
Recommendations	15.8	34.3
Level of skills	10.5	38.5
Professional experience	44.0	37.0
Age	1.8	19.8
Gender	0.0	4.5
Motivation	7.5	31.8
Other (please specify)	1.0	2.3
Don't know	3.0	-

When selecting new employees, the criterion most commonly mentioned as the 1st priority is professional experience; however, *personal* and *collective* trust ("I know future employees" and "recommendations") play a considerable role as well (Table 52). Among the 2nd most important criteria the role of trust is more modest, and only in the form of indirect trust. The same is true for the 3rd priority criteria.

However, this general conclusion must be qualified a comparison of regional and sectoral variations. In Moscow direct trust plays a much more important role compared to indirect trust; precisely the opposite holds true for Kaluga. The role of direct trust is more important in services, start-ups and young firms and in micro enterprises, whereas in the food industry and especially in trade, as well as in older and bigger SMEs, recommendations are more important when selecting employees.

Taken together, the 2nd and 3rd most important priorities give the following picture: the most important criterion is level of skills, followed by professional experience and recommendations. All other factors are of much less importance.

A personal knowledge of the future employee is more important in Moscow, in start-ups and in young SMEs; *recommendations* in Voronezh, start-up firms, and in services; *level of skills* in Moscow and in SMEs in the food industry; *professional experience* in start-ups and in Moscow; *age* in Kaluga and Nishny Novgorod; *motivation* in Kaluga and in food industry SMEs.

Despite the fact that informal methods of personnel recruitment play a major role, there is relatively little trust in employees (Table 53).

Table 53: To what extent do you feel you can trust your employees to work effectively when they are not supervised? Please assess on a scale from 1=absolutely to 5=not at all. (in %)

1	11.3
2	19.8
3	39.3
4	13.0
5	13.0
Don't know	3.6

Here, the balance between the positive (1 and 2) and negative (4 and 5) assessments is only a little in favour of the positive results. Most entrepreneurs were not sure whether employees could be trusted to work effectively without supervision. Maybe this is a sign of insufficient motivation and/or low level of payment of employees in SMEs.

Again, trust is higher in Kaluga than in Moscow and Nishny Novgorod, in services than in trade, and in older SMEs than in younger ones.

Institutional and Social Environment

One important deficit in a transitional economy is a lack of trust (or, better, confidence) in institutions and in the stability of the entire environment. This is partly a consequence of widespread anomie (lack or disintegration of morals and social standards) and partly of dramatic changes in the legal and other institutional framework for business, which especially affect small companies.

Membership in Business Associations

Different methods can be used to minimise risks for business. Apparently, membership of business associations etc. was not the preferred method among surveyed entrepreneurs (Table 54).

Table 54: Are you a member of one or more business associations? (in %)

No	87.9
Yes	12.1

Unlike Germany and some other Western European countries, the total number of members of business associations in Russia is very small. The chairman of the All-Russian organisation of SME associations "OPORA" estimates that ca. 5% of small entrepreneurs participate in such associations⁹: most of these associations exclusively lobby the interests of a few founder firms in local and regional executive bodies; the real influence of such associations on the economic environment is very low; membership is not obligatory, but voluntary. Hence, a small entrepreneur, comparing the costs and possible benefits, is usually not sure whether membership will help him/her to solve his/her real problems (cf. Table 55).

The membership in business associations is more widespread in services, among Nishny Novgorod entrepreneurs and less widespread in trade firms, in Voronezh.

Table 55: Please assess the value of your memberships to the success of your business. (in %)

Of no value	1.2
Of little value	6.3
Of high value	4.5
Not applicable	87.9

Even the respondents who are members of a business association are to a great extent dissatisfied with the activities of these associations in promoting and supporting member interests.

In this case, there are no discernible differences in each of the regional, age, branch etc. groups.

Relations with Authorities

The most complicated area is relations between entrepreneurs and authorities.

⁹ See: Zashitit biznes ot 'zashitnikov', in: Biznes dlya vsekh, No. 25, July 2003, p.6.

Table 56: To what extent do you consider the relations between official bodies and private firms such as yours as either helpful for, or a constraint to business success? Please rate each authority on the scale below. (in %)

	Very helpful	Helpful	Neutral (neither helpful nor a constraint)	Constraint	Major constraint	Don't know	No answer
Federal government	0.3	2.8	52.5	14.3	6.0	22.0	2.3
Federal legislative	0.3	1.5	53.3	12.0	5.8	24.3	3.0
Regional government	0.3	3.8	55.0	17.3	7.3	14.5	2.0
Regional legislative	0.0	1.3	53.0	15.3	6.0	21.5	3.0
Local bodies	1.3	6.5	47.3	28.3	9.5	6.5	0.8
Court	0.0	1.5	60.0	5.3	0.3	29.3	3.8
Court of arbitration	0.0	3.5	58.0	5.0	0.3	29.3	4.0
Other (please specify)	0.0	0.5	0.3	0.5	1.3	0.0	97.5

As Table 56 shows, all levels of state authorities are more of a constraint to business – moreover, the “nearer” a body is to SMEs, the more negative respondents’ assessment of their role in the economic environment. This specific feature of relations between SMEs and authorities in Russia is mainly caused by the disproportional distribution of tax incomes: local bodies receive a very small part of taxes paid by entrepreneurs. Because of this the local level is not very interested in support and promotion of small private firms. Other factors – political orientations of regional/local bodies, the level of bureaucracy and corruption – are of secondary importance.

Thus, the differences between the various cross-sections are significant only from the regional point of view. *Federal* bodies are considered to be a constraint more frequently in Kaluga, less so in Voronezh. The same is true for *regional* bodies. (At this point, it can also be added that the older the firm is, the more negatively it judges regional legislatures.) As for *local* bodies, they received the best “grades” in Moscow, in the food industry and in younger SMEs, and the worst “grades” in Kaluga. The courts and court of arbitration are, again, viewed as a constraint much more frequently in Kaluga than elsewhere.

Table 57a: When dealing with authorities, do you consider any of the following issues a problem for private firms such as yours? (in %)

	Don't know	No	Yes
Unfriendly or impolite treatment	29.3	33.8	37.0
Excessive paperwork	12.3	10.3	77.5
Explicit or implicit requirement to give bribes	19.5	25.0	55.5
Time consuming procedures	9.0	7.3	83.8
Lack of competence among officials	14.3	20.3	65.5
Favouritism	39.0	31.3	29.8
Other (please specify)	0.0	98.8	1.3

Table 57b: If yes, to what extent? (in %)

	Minor	Moderate	Major	Not applicable
Unfriendly or impolite treatment	18.0	13.5	5.5	63.0
Excessive paperwork	13.5	31.3	32.8	22.5
Explicit or implicit requirement to give bribes	15.5	28.0	12.0	44.5
Time consuming procedures	11.3	34.8	37.8	16.3
Lack of competence among officials	18.0	29.8	17.8	34.5
Favouritism	13.8	9.3	6.8	70.3
Other (please specify)	0.0	1.0	0.3	98.8

As one may see (Tables 57 a–b), the most common problems for SMEs are time consuming procedures, excessive paperwork and the lack of competence among officials. *Contrary to the general view of experts, bribes were not mentioned as the greatest problem of small businesses in Russia* (at least, in the interviewed entrepreneurs' opinions).

Unfriendly or impolite treatment is more often a problem for Moscow and Voronezh, firms in the service industries, start-ups and old SMEs; in fact, it is viewed as a major problem twice as frequently in Moscow and by start-ups. *Excessive paperwork* is a constraint in Voronezh (for 94% of all respondents in this city!) and for trade enterprises. It is a major limitation for Kaluga and Nishny Novgorod entrepreneurs and for traders. *Bribes* are viewed as a problem in Moscow and Kaluga, by start-ups and old firms. Moscow entrepreneurs, traders, start-ups and old firms consider bribes to be a major constraint more frequently than others. *Time consuming procedures* were mentioned as a problem in Voronezh (again, by 94% of interviewed entrepreneurs), in trading firms and by old firms. In this case, they were also more often mentioned as a major constraint. *Lack of competence among officials* is viewed as a problem in Kaluga and Voronezh, in services, by older and bigger firms; this is much more seldom in Moscow and Nishny Novgorod. In Kaluga and in service firms it is more frequently a major or moderate constraint. *Favouritism* is a problem in Moscow (where a significant amount of budget money is spent for services and products delivered by private firms for city needs), services and by older firms. Paradoxically, the problem was mentioned as a major constraint not in Moscow, but in Kaluga.

The state bodies most often contacted by small entrepreneurs are various control and regulating institutions (Table 58).

Table 58: How would you describe your and/or your managers' relations to the following persons? (in %)

	Friendly	Neutral	Bad	No contacts	Don't know
Tax inspector	17.5	72.5	7.3	1.5	1.3
Fire inspector	12.0	59.8	8.8	15.0	4.5
Trade inspector	7.3	51.0	7.8	27.3	6.8
Ecology inspector	4.0	33.0	1.3	48.8	13.0
Local police representative	16.5	44.3	2.8	28.3	8.3
Labour inspector	4.8	44.5	3.5	33.5	13.8
Other (please specify)	10.8	46.3	11.0	27.3	4.8

Good or neutral relations are more frequently established between entrepreneurs and local police, labour and ecology inspectors. (In their free time, local police officers are very frequently bodyguards of small firms or even – a widespread “practice” – play the role of the so-called *krysha* [literally “roof”], which means they have taken the place of the protection racket of the early 1990s.) Neutral or even bad relations exist with tax, fire and trade inspectors. *We assume that friendly or neutral relations are often based on different forms of corrupt practices, as this is a conclusion that can be drawn from various other Russian surveys.*

A cross-sectional comparison can give a more precise picture. Relations with *tax inspectors* are more frequently bad (and also more frequently good) in Moscow; start-ups have bad relations with these officials, whereas SMEs in the food industry and older firms have good relations with them. *Relations with fire inspectors* are more frequently bad in Kaluga, more frequently good in Nishny Novgorod, in the food industry and from the point of view of old SMEs. *Relations with trade inspectors* are more frequently friendly in Nishny Novgorod and bad in Kaluga and Moscow; in the food industry there are less entrepreneurs who chose the assessment “neutral” and more who chose both “bad” and “friendly” (however, the causes of such a polarisation are not clear). *Relations with local police* are more frequently friendly in Moscow, the food industry SMEs and mature firms.

Sources of Assistance and Advice and the Role of Trust

Advice is normally sought from a trustworthy source (cf. Table 60), which most of the entrepreneurs surveyed usually find in established business partners, and family and friends (Table 59).

Table 59: To whom do you turn when you need assistance and advice in your business?

Please name up to 3 in order of priority. (in %)

	1 st priority	2 nd and 3 rd priorities
No assistance needed	25.7	-
Employees	9.7	19.3
Family and friends	21.8	25.4
Established and regular business partners	34.1	24.5
Consultants, business support agencies	3.6	9.1
Business associations, chambers	0.9	3.9
Contacts in local authorities	3.6	21.5
Other (please specify)	0.3	1.2

Among the second place priorities the ranking remains the same, but upon a closer look employees and contacts in local authorities take the second places. Among the third place priorities, however, only family and friends remain at the top positions; other important sources are contacts in local authorities and employees. Here, again, the role of business associations and chambers, as well as that of consultants and business support agencies (because their services are too expensive for many small firms), is negligible.

Looking at the various regions and sectors, we can see that *employees* are more often a 1st priority source of assistance in Moscow and Nishny Novgorod; in Kaluga and Voronezh, on the other hand, entrepreneurs don't turn to employees. In addition, food industry SMEs turn to employees somewhat more frequently. *Family and friends* are important sources of assistance in Nishny Novgorod and Moscow, for firms in the food industry, but especially – the reason is obvious – for start-ups. On the other hand, Voronezh SMEs, service firms and mature firms ask family members and friends less frequently for assistance. *Established and regular business partners* play a key role as assistants for Voronezh and Kaluga firms, in services, for mature

enterprises and for small firms with 10 to 49 employees. *Contacts in local authorities* are more frequently used by firms in the food industry.

The aggregate total of the 2nd and 3rd priorities shows that employees and family and friends play a much more significant role as advisers. *The assistance of employees* is more frequently required by start-ups (nearly one-third!), Moscow SMEs and firms in the food industry; the *assistance of family and friends* in Nishny Novgorod (up to one third), in the food industry; that of *regular business partners* in firms in the food industry and in Moscow (in both cases one-third!), as well as in old SMEs; of *consultants, business support agencies* in Nishny Novgorod and in trade; of *contact persons in local authorities* in the food industry and in Moscow.

Table 60: In deciding who to turn to for assistance, how important is trust in comparison with other factors? Please assess on a scale from 1=very important to 5=of no importance. (in %)

1	45.3
2	9.7
3	9.1
4	3.6
5	5.1
Not applicable	25.7
Don't know	1.3

It is evident, that – taking into consideration the informal ties between entrepreneurs and the most important sources of assistance – trust plays a key role in deciding who to turn to: more than 45% of all respondents mentioned trust as very important or important (Table 60).

It is very important in Kaluga and Nishny Novgorod and somewhat more important for start-ups. It is less important in more pragmatic Moscow and individualistic Voronezh, and somewhat less important in the food industry.

Force majeure is a frequent hazard in business deals. Therefore, it was very important to know what sources of protection entrepreneurs normally use – keeping in mind that the institutional milieu is weak and unstable, and the source of help to which entrepreneurs most often turned in all circumstances were business partners (Table 61).

Table 61: If you experience problems with your business partners, to whom do you turn? Please tick below as appropriate. (in %)

Court	30.2
Court of arbitration	30.8
Chamber of commerce, business association	4.8
Mutual business partners	48.0
Mutual relatives and friends	27.2
Others (please specify)	3.0
Not applicable	50.8
Don't know	3.6
Nobody	15.1

First of all, it must be stressed that more than two-thirds of the sample did not have any serious problems, or turned to no one in such cases. Furthermore, it is evident that in case of problems with business partners an independent third party must be found – usually a common business partner. Moreover, due to the fact that many commercial problems can still be dealt with both by the courts of arbitration and by the common courts, the common (civil) courts appeared as often in the data as did the arbitrary courts.

Unlike the early 1990s, mutual relatives and friends do not play the most significant role any more. Lawyers' services are not used, perhaps because they are too expensive for the average small firm in Russia.

The most important conclusion to be drawn from a cross-sectional analysis is the fact that start-ups go to court most frequently (more than half!), and young SMEs likewise to the court of arbitration (more than 40%). *Maybe this is a sign that a sense of what is right and wrong and respect for the rule of the law is being established among younger Russian businessmen/businesswomen.* Besides, the *courts* were more frequently mentioned in Moscow (more than one-third); the *court of arbitration* in Voronezh (one third); *chambers of commerce and business associations* by start-ups (more than 60%!) and young firms; *mutual business partners* by start-ups, young firms and Moscow entrepreneurs.

As Table 62 shows, when dealing with authorities a significant share of the interviewed entrepreneurs claimed they needed no assistance at all (which can be interpreted in more than one way: one might have no need for assistance, or not have any dealings with the authorities).

Table 62: Do you rely on assistance in dealing with authorities? If yes, to whom do you turn? Please name up to 3 in order of priority. (in %)

	1 st priority	2 nd and 3 rd priorities
No assistance	34.3	-
Employees	4.8	12.5
Family and friends	15.5	18.0
Established and regular business partners	22.0	22.5
Consultants, business support agencies	2.0	7.0
Business associations, chambers	2.0	2.5
Contacts in local authorities	19.0	23.5
Other (please specify)	0.5	0.3

On the other hand, entrepreneurs who have contacts with the authorities and needed help received it from established and regular business partners (they figure among the 1st, 2nd and 3rd priorities), contact persons in the authorities and from family and friends. In addition, employees were also relatively often named as a 3rd priority.

Among mature firms and in Kaluga, *established business partners* were the 1st priority as assistants. *Contacts in local authorities* are used more often in Moscow and Kaluga. *Family and friends* were frequently named in Nishny Novgorod and by start-ups; *Employees* in Moscow and by SMEs in the food industry.

The aggregate totals of the 2nd and 3rd priorities show that contacts in local authorities, established business partners and family and friends are the main sources of assistance for entrepreneurs when dealing with the authorities. Employees are the preferred source of help in the food industry and in Moscow; *family and friends* for young firms, in Moscow; *established business partners* in Moscow (more than one-third) and in the food industry; *consultants* etc. in Kaluga; *contacts in local authorities* – in Kaluga (more than one-third) and for food industry firms.

Trust was often an important factor in such cases (Table 63).

Table 63: In deciding who to turn to for assistance, how important is trust in comparison with other factors? Please assess on a scale from 1= very important to 5=of no importance. (in %)

1	39.3
2	7.0
3	10.3
4	3.8
5	3.0
Not applicable	34.3
Don't know	2.5

Trust was more important in Kaluga, but less important in Moscow and among SMEs in the food industry.

Furthermore, the help of third parties was very important for more than half of the entrepreneurs surveyed (cf. Table 65) during the start-up stage of their firms (Table 64).

Table 64: What were the main constraints for business development when you started your business? Please name up to three in order of priority. (in %)

	1 st priority	2 nd and 3 rd priorities
Capital and financing	50.0	11.3
Premises	14.3	18.8
Equipment	4.8	12.0
Employees	4.5	13.3
Information	3.3	7.3
Search for market	11.8	17.3
Regulations	5.0	8.3
Macroeconomic environment (e.g., high inflation, competition)	5.0	8.3
Other (please specify)	0.3	0.8
Don't know	1.3	2.5
Not applicable – No problem	1.0	-

Among the 1st priorities, capital and financing were, as one would expect, the most important constraints during the start-up period. The second most important were premises; the third finding a market niche. The search for a market niche was also named under 2nd and 3rd priorities – capital and financing were replaced by equipment among the 2nd and especially 3rd priorities and premises were replaced by personnel problems. *Nota bene: state regulations were not mentioned among the most important constraints, and nor was information; macroeconomic environment – inflation, unemployment, low demand, lack of stable banking, financial crisis etc. – was also considered to be one of the less urgent problems faced by Russian start-ups.*

The most crucial 1st priority constraints were as follows: *capital and finance* in Voronesh and the trade sector; *premises* in Kaluga; *equipment* in Voronesh and among services; the *search for market niche* in Kaluga and the services; *regulations* in Moscow and the food industry; the *macroeconomic environment* in Moscow.

Capital and financing were considered less of a problem in Kaluga and service SMEs; *premises* in Moscow and in trade; *equipment* in Kaluga and in trade; the *search for a market niche* in Voronezh, Moscow and Nishny Novgorod, as well as in trade.

If we add together 2nd and 3rd priorities, the three most important constraints were: the search for a market niche, premises, and employees. *Capital and financing* were a more urgent problem for start-ups in Kaluga (one-third of the regional sample), in the food industry and for mature firms; *premises* in Kaluga and for start-ups (more than 40% in each of these groups) and for food industry SMEs; *equipment* in Kaluga and for food producing enterprises; *personnel* in Moscow, for start-ups and young firms, in service SMEs (more than one-third in each of these groups); *information* for services firms, in Moscow, for young SMEs; the *search for a market niche* for young firms in trade; *regulations* in Voronezh, for trade enterprises, and old SMEs; the *macroeconomic environment* for Moscow SMEs (more than one-third), young firms (which were founded after the crisis of 1998) and in trade.

Table 65: Did anyone else help you to deal with these problems? (in %)

No	45.0
Yes	54.0
Not applicable	1.0

More than half of the interviewed entrepreneurs received help in dealing with problems during the start-up phase. Moscow firms and food industry enterprises received assistance more often.

What about those entrepreneurs who did not use any help from third parties?

Table 66: If not, did lack of trust play a role for you for not using outside help? (in %)

No	35.3
Partly	8.0
Yes	1.8
Not applicable	55.0

Contrary to our assumptions, *lack of trust did not play a significant role in the decision for not using outside help during the start-up period* (Table 66) – rather, it was lack of social capital (people didn't know any persons or institutions that could help) or the fact that such help was unnecessary. In fact, only every fourth entrepreneur did not use outside help because of lack of trust.

The three main sources of help were business partners (this is somewhat confusing: at the time of their foundation a significant share of start-ups already had business partners), friends and family (Table 67).

Family and *friends* were more often used by Moscow start-ups and food industry SMEs, and less often in Voronezh and by services firms; *friends* were seldom asked for help by mature SMEs (this is maybe a result of the financial crisis on the start-up process immediately after 1998). The help of *employees* was made use of twice as often in Moscow and two times less often than the sample average in Nishny Novgorod. The help of suppliers was utilised almost twice as often in trade, but in Voronezh and in Kaluga only to a negligible extent. *Business partners* were asked for help more often by entrepreneurs in the food industry, in Moscow and Kaluga and in bigger SMEs, but rarely in trade, by micro firms, and very seldom in Nishny Novgorod. Entrepreneurs turned to *previous colleagues* somewhat more often in Moscow and Kaluga and very rarely in Voronezh. SMEs in the food industry and in Moscow turned more

readily to the *local authorities*, whereas SMEs in trade and in Voronesh rarely used this form of assistance.

Table 67: If somebody helped you, who? Please tick as appropriate. (in %)

Family	19.5
Friends	27.0
Employees	7.3
Customer	1.0
Supplier	6.0
Business partners	31.0
Previous colleagues	11.5
Local authorities	4.5
Other (please specify)	0.8

Why did these persons help and why were entrepreneurs confident that they could accept such a help?

Table 68: Did you trust those providing help to act in your interest? (in %)

No	3.3
Yes	50.8
Not applicable	46.0

Confidence that the people and firms helping them were acting in the interest of the entrepreneur played the major role (Table 68).

Moscow and food industry entrepreneurs trusted persons who helped them more than the average, whereas Voronesh entrepreneurs and trade start-ups had less trust.

Almost half of the entrepreneurs received no help or did not need it. For those who did use help, the main reason for being confident that the helper could be trusted was friendship (personally based trust). In addition, 7.5% of interviewees stressed that those who helped were acting in their own financial interest (rational choice). Other factors were negligible.

Table 69: If yes, why do you trust them? E.g., no alternative, you knew them, etc. (in %)

relatives	3.5
friends	22.3
no other choice	5.5
partners	5.0
it was in their own financial interest	7.5
former colleagues	3.0
personal abilities	1.5
other	0.5
Not applicable	49.3
Don't know	3.5

Case Study Report

The main idea of the case study was to prove whether personal, collective and institutional trust could be clearly identified and described in terms of ‘low’ and ‘high’ trust areas, in combination with the results of the quantitative survey.

For the purpose of the case study, three cities were chosen out of those where the survey was conducted in summer 2002 – Moscow as capital, Nishny Novgorod as a big provincial city and Kaluga as a medium sized town in the heartland of Russia.

In these cities, 27 entrepreneurs were interviewed between December 2002 and February 2003 (see Annex 1). Many of them were owners of more than one firm; this made it difficult for them to extract the topic related data (often, employees work for more than one firm of the same owner, some of the owners could not give figures of turnover etc. for a single firm, as they only had data for all the firms etc.).

The main results of these in-depth interviews, as related to the main project objective, are as follows.

Profile of Companies and Entrepreneurs

Table 70: Characteristics of firms investigated in the case study

No.	City	Year of establishment	Sector	No. of employees	Remarks
K-1	Kaluga	1995	Trade	60	
K-2	Kaluga	2000	Business oriented services	4	
K-3	Kaluga	1995	Business oriented services	70*	The firm has branches in 3 cities, the number of employees in Kaluga is ca. 25–30 persons
K-4	Kaluga	1995	Business oriented services	18	
K-5	Kaluga	1997	Trade	19	
K-6	Kaluga	1992	Business oriented services	15	
K-7	Kaluga	1998	Trade	15	
K-8	Kaluga	1993	Food industry	8 (?)	
K-9	Kaluga	1994	Food industry	45	
K-10	Kaluga	1997	Food industry	5	
M-1	Moscow	1996*	Business oriented services	14	Spin-off of a firm existing since 1992 with the same profile
M-2	Moscow	1996	Business oriented services	12 (?)	
M-3	Moscow	1992*	Business oriented services, print production	9	Since 1992 on an informal base (as a department of a scientific institution), formal start-up in 1994

No.	City	Year of establishment	Sector	No. of employees	Remarks
M-4	Moscow	1994	trade	3	
M-5	Moscow	1999	Animation production*	5 (?)	Part of a group of business orientated and personal services firms
M-6	Moscow region	1995	Food production	Up to 50	
M-7	Moscow region	1997*	Trade	11 (?)	Spin-off of a firm (belonging to the same person) which had existed since 1991
NN-1	Nishny Novgorod	1998	trade	3	
NN-2	Nishny Novgorod	1996	Trade	30	
NN-3	Nishny Novgorod	2000	Food industry	10	
NN-4	Nishny Novgorod	1995	Food industry	10–49	
NN-5	Nishny Novgorod	1991	Business oriented services	8 permanent employees, 5 freelancers	1991 – foundation 1998 – active business
NN-6	Nishny Novgorod	1985	Construction/services	2	1985 – foundation as a large firm 1995– in present form
NN-7	Nishny Novgorod	1996	Business oriented services	Up to 10	
NN-8	Nishny Novgorod	1995	Business oriented services	10–49	
NN-9	Nishny Novgorod	1991	Business oriented services	10–49	
NN-10	Nishny Novgorod	1997	Business oriented services	Up to 10	

Interfirm Relations

Personal Trust

A typical '*customers market*' exists in the Russian cities where the case studies were conducted. That is why informal relations with customers, suppliers, and co-operation partners play a big role in cultivating existing relations, and not in establishing new relations, unlike the early 1990s. It is important to *have a good reputation with the customer's representative*, as this is the basis for better conditions of payment, and delivery can be achieved or payment may be deferred to a date later than initially agreed without detriment to the established relations. If, however, relations with the customer did deteriorate, most of the interviewees were able to find new customers very easily. Moreover, *trusting clients is much more important*, because here the firm itself has to offer sales or consignment; if the client does not pay this can lead to net losses. In addition, it would be necessary to find new clients – that is why the role and importance of personal contacts in developing and managing relations and enforcing contracts with clients (safe-

guards, risk involved, etc.) leads to an orientation on ‘trust based’ relations with clients with the aim of making them ‘friends’ – as everybody is confident that in cases of infringement of contract the only possible way to avoid losses is a personal tie to the client.

A question that should be considered in more detail at this point is the following: is the strategy of entrepreneurs to cultivate good relations with the clients based solely on trust, or on self-insurance? Or must personal trust in general be seen as the equivalent of self-insurance from the point of view of economic science?

This is quite different in retail trade: in this area, personal trust is much more important in relations with customers. If you have a trustworthy firm, you may benefit from discounting and sales actions, you may have access to the customer’s own networks (and conclude other business deals on this basis), or you may enjoy a consignment instead of a prepayment. On the other hand, the situation of suppliers is completely different: they have to create networks of trust in order to work with petty traders at all. As there are no credit histories, loan guarantees or such-like in this area, and retailers can vanish from one day to the next without paying for the last delivery, entrepreneurs who cannot build up a balanced trust relationship sometimes even decide to change their market niche so as to be able to work with clients who possess greater assets, i.e., cannot simply vanish if the worst comes to the worst.

There is a general realisation that business implies contradictions and embarrassing situations, which are easier to resolve if they do not occur within the circle of relatives and friends, but rather outside of this circle (‘if you want to lose a friend, start doing business with him’). Nowadays, unlike in the early 1990s, friendship is not a *precondition* for business any more, but often a *side effect* and *consequence* of established and perfectly functioning business relationships.

Personal trust is needed when dealing with informal borrowers, because it is the single precondition of money lending in the shadow economy. Here, personal trust can, to a certain extent, play the role of a credit history, as well as serve as a substitute for securities and guarantees.

Furthermore, the role of trust is different in different sectors, as well as in different milieus: in areas where the number of potential customers/clients is small, the role of trust is less crucial; in sectors with standardised mass products or services, where everyone can change customers/clients very easily (fast food services, retail trade etc.) trust is an obligatory precondition of stable relations between firms.

Collective Trust

Business conventions do, in fact, function. The role of unwritten rules in dictating business relationships, and governance and enforcement mechanisms is high – but entrepreneurs do not reflect on this and are not able to formulate which conventions they follow.

Most entrepreneurs follow such conventions without reflection – everybody is confident that in case of temporary non-liquidity or a similar difficult situation every partner will try to do everything possible to pay his debts without resorting to the courts (one example of such a statement: ‘Everybody can find himself in such a situation – you have to be decent to people, so that they will be decent to you as well’).

Institutional Trust

None of the interviewees would base a business deal on an informal or oral agreement; formal contracts with customers, suppliers and co-operation partners are the rule¹⁰. However, there is little reliance on the law when enforcing contracts – thus, while written contracts are more or

¹⁰ This does not contradict the data of the survey, according to which many entrepreneurs mentioned that they deal with their partners without any written contract. A common situation is that in existing business relationships new transactions are initially discussed and agreed on orally and only later covered by a formal contract. This is often done not because of a lack of trust, but out of fiscal and accounting necessity.

less 'formal', it is common business practice to avoid formal sanctions, penalties, arbitration and the courts (not so much because of a lack of confidence in the result, but because of the long duration of lawsuits and considerable time consumption involved in legal contract enforcement).

Relationships with Third-Party Intermediaries

Personal Trust

Informal channels for obtaining information and advice, i.e. family, friends, are quite common, despite the fact that the period of business oriented towards family and friends is definitely over. If the help of an intermediary is needed, entrepreneurs ask their customers or clients, or use the services of intermediary firms: a good reputation with a supplier or client can help to open up new market options.

Collective Trust

Asking business associates for advice is a relatively widespread practice. In highly specialised markets where there are only a few actors, there is often an informal exchange of information on suspicious clients/partners, the solvency of individual potential partners, etc. That is, without regarding this as a form of co-operation or a 'convention', potential competitors exchange information. In this they are guided by a generally accepted concept of 'fair' competition.

On the other hand, membership of formal or informal entrepreneurial associations is not considered very desirable – with the exception of those that might lead to useful connections to 'leading persons' (governor etc.) – i.e., the only positive role of such associations would be to establish access to an informal network between the local entrepreneurial elite and the authorities. However, some of the interviewees were strongly against such activity because of the time they consumed and the fact that *'if you are a member of such an association, you are one of those whom the authorities will politely ask to provide them with 'voluntary help' in order to pay for the social needs of the city etc.'*

Institutional Trust

Almost none of the interviewees could remember having received support (information or advice) from 'anonymous' organisations: business associations, support agencies or chambers.

An important feature of the situation in the cities observed in our case study is that there are apparently two cohorts of entrepreneurs: (a) the few dozens (or hundreds, in the case of Moscow) who are able to exploit their membership of public bodies and/or access to the authorities to the (considerable) benefit of their companies, and (b) the overwhelming majority of entrepreneurs who do not have access to intermediary and public organisations.

A reason for this is probably that information in Soviet times was always "confidential"; people who had access to certain information could convert this into power and influence. Today, such information (e.g., possibilities of financial support, exhibitions, etc.) is converted into cash. Only a small proportion of Russian entrepreneurs use the databases (at federal, but also at regional level) that are being set up – a situation which could change with the spread of access to the Internet. On the whole, the creation of various Internet databases and the development of the Internet must be seen as one of the most efficient means to minimise the above mentioned inequality.

Intrafirm Relations

Personal Trust

Informal decision-making structures are based purely on personal trust – no one mentioned any documents or written agreements regulating the decision-making process within the sphere of owners/co-owners.

The informal involvement of employed managers in complex decisions is usually very high, but only in the areas for which they are responsible. In the interviews, it was mentioned more often than in the case of business partners that their competencies are regulated by written contracts.

Employees' initiatives are welcomed, but a strategy to support them or to stimulate the results of such initiatives was mentioned very rarely, especially in Moscow.

A need for employee control is high – regardless of the period he/she has been employed at the firm (several statements in Moscow) or depending on personal knowledge of the person (Kaluga).

The problem of motivation is treated quite differently – there are a lot of interviewees who mentioned that the sole incentive was a high salary (the lion's share of which is paid 'unofficially'). There were isolated cases when entrepreneurs developed several mechanisms to take on employees and to increase their loyalty to the firm ('corporate identity').

Collective Trust

In most cases, entrepreneurs hire employees on the basis of recommendations by persons from the same town or by colleagues; however, nowadays not only good 'recommendations', but also concrete knowledge and experience are expected from a potential employee.

Moreover, the fact that all of interviewed persons mentioned that labour contracts with employees are a pure formality – real input and salary are governed by unwritten agreements, and everybody accepts this – show that a certain collective trust in unwritten laws exists on both sides.

Institutional Trust

A clear indication of the fact that no confidence is placed in the state is the fact that employment contracts as a rule are mere paper: in reality, job descriptions and the modalities of payment are fixed by oral agreement. This is a consequence of the following facts: (a) that the regulations concerning employment contracts in a small enterprise are removed from reality, (b) that social insurance contributions are too high, (c) pure and simple ignorance of the labour laws in force.

Regulation and Business Environment

Personal Trust

The use of third parties (friends, business associates) to deal with the authorities is quite unusual. The practice of using personal connections with a representative of the authorities (who is sometimes paid for his/her advice) or of a business partner who has useful connections is more common.

Collective Trust

The importance of membership of permanent networks (be they local or nationwide) is very high. As a consequence, new transactions are initiated significantly faster and without any formalities, often without a formal contract and advance payment.

Against expectations, in the case studies there were no visible indications of 'collective trust' between members of the same ethnicity, confession or even less between former members of the

party or the Communist youth organisation. To a certain extent, one can speak of 'local identity' (some interviewees in Nishny Novgorod admitted to preferring doing business with local partners, as they come from the same town and *'know the ropes'*).

Caucasians¹¹ are a manifest exception: there were not a few statements on the part of the interviewees that they would not do business with persons of Caucasian origins (*'after all that has happened there I don't like them'*), more often, there were attempts to argue that the mentality of the Caucasian peoples is *'completely different'*, thus they have a different view of how to deal with certain matters: one cannot presuppose that certain rules and norms of conduct, never spelled out openly but accepted and shared by entrepreneurs of Russian origin, are viewed in a similar way by Caucasian partners. This leads to misunderstandings and semi-criminal situations and places stress on business.

Unlike *'those'* Caucasians (as a rule, citizens of Azerbaijan and of the republics belonging to the Russian Federation in the northern Caucasus), who have migrated en masse to the Russian cities within the last years, people from the Christian Transcaucasian republics, Georgians and Armenians, who have lived in Russia for decades or even centuries, are tolerated. There are no statements to this effect, but one can infer from the context of the interviews that this is because they have settled in and accept the informal rules and norms.

Institutional Trust

Generally, the state is treated as the biggest obstacle to and danger for business. The state is, thus, really more of a 'bandit' than a regulating body. That is why, informal conventions and the 'common law', and not official laws and regulations, are the true basis of any entrepreneurial activity in Russia.

The treatment by authorities, especially tax agencies and other bodies with the power of inspection (fire, sanitary etc.), is relatively often impolite and highhanded. The most common problems in dealing with these controlling bodies are the low level of competence of their personnel and contradictions in regulations, rules and legislation that can be applied by the bureaucrats in a very arbitrary manner. Hence, bribes are a solution in order to minimise the transaction costs with regulating bodies; bribes – often in form of a gift for a holiday etc. – are usually viewed as a form of the symbolic affirmation of 'trust' and 'sympathy' for a bureaucrat, not as a break of common law and ethics. In fact, such 'sympathy' is instead a way of signalling loyalty to these authorities (combined with an attempt to prove how corrupt the person in question is in order to use his/her 'services').

The use of 'anonymous' third parties such as consultants and tax consultants to deal with authorities is unusual. More often there are personal ties or corrupt practices ('I've paid a person in such-or-such an authority. He/she will inform me on all obstacles and problems I could be confronted with'), which are used to reduce or avoid further contradictions with inspecting bodies.

Environment and Factors Limiting/Influencing Entrepreneurial Behaviour (Expert Interviews)

A series of interviews with 12 representatives of federal and regional state institutions and bodies, as well as with some activists of business associations, was conducted in order to describe

¹¹ Persons from the Russian part of the Caucasus Mountains and from former Soviet republics with territory in the Caucasus Mountains.

and explain the entrepreneurial environment which directly influences entrepreneurial behaviour in Russia¹².

The general picture conveyed by these experts is as follows: The main environmental factors influencing entrepreneurial behaviour in the SME sector are: (a) legal regulations that are contradictory and not transparent, and the fact that there is no clear regulation of certain important social spheres; (b) the weak framework of SME policy; (c) the corrupt practices employed by controlling state bodies; (d) the fact that there is no strong lobby of small business in the legislature or executive at both the federal and regional levels.

a. Legal regulations that are not transparent are partly a consequence of the changes in society: legal acts adopted during the initial stages of the reforms do not conform to new legal acts designed to protect newly established civil, entrepreneurial etc. practices. As for contradictory laws, some experts have mentioned mutually contradictory federal laws – for instance, the Civil Code and the Tax Code. This is partly a consequence of the federal structure in a state where federation and regions are competing with each other in many ways. So, in cases when federal and regional acts contradict each other, courts usually decide in favour of regional law (*'the region is nearer, so one may count on more enforcement from the region'*, as one interviewed person said). Another important fact is that many regional legal acts limit the general freedom of entrepreneurship declared in the Constitution and several other federal acts.

Furthermore, the relations between entrepreneurs and society are in general regulated better than the relations both between entrepreneurs and the state, especially in regards to control procedures, sanctions, and taxation, and between entrepreneurs and employees. Therefore, there is much leeway for the courts in cases concerning these spheres. *'And in a case where a court had such leeway, it would decide in favour of the entrepreneur and to the detriment of the State'*, as one respondent formulated this 'rule'.

Hence, despite the fact that legal experts were confident that the number and significance of contradictions within the law are on the wane, the factors described above inspire in the normal small entrepreneur a view of the law as opaque, which engenders his distrust in the law. The following entrepreneurial behaviour patterns arose because of this: the overwhelming majority of entrepreneurs try to use "niches" or contradictions within the law by 'buying' positive treatment from the state institution responsible, and a small proportion of SMEs attempt to combat legal contradictions publicly, which entails significant costs (and loss of reputation in the eyes of state bodies).

b. With regards to SME policy framework, respondents described the main efforts as well as main failures and inequalities as follows:

- The entire regulatory environment and legislative foundation for small business promotion is based on the major 'Federal law on state support for small enterprises' (1995), and includes a series of other laws – for instance, on unification and simplification of business registration, unification of licensing procedures, development of financial leasing, participation of SMEs in state procurement, facilitation of small business access to information, the federal law on a simplified system of taxation, records and accounts for small enterprises (up to 15 employees), etc. A substantial number of positive changes were introduced into the regulatory environment at regional level. However, there are many loopholes in these legal acts, they are contains many provisions contradictory to Tax and Budgetary codes and

¹² In June – July 2003 representatives of the following bodies were interviewed: Ministry of Economic Development and Trade, Head of Department; Ministry of Antimonopoly Policy and Entrepreneurship Support, Deputy Minister; Moscow City Duma, Head of Commission for Entrepreneurship; Association of Entrepreneurial Organisations „OPORA“, Executive Director; Russian Association for Small Entrepreneurship Support (RARMP), Executive Director; Public Expert Council for Small Entrepreneurship by the Maitre and the Government of Moscow City, Executive Secretary; Member of the Court of Arbitration of Tomsk Oblast; Legislative Council of the Republic of Karelia, Consultant; Law consultant of a real estate firm, Yekaterinburg; 'Yugra' Ltd., Investment Company, Deputy President; Russian Centre for Micro-credits, Director; KMB-Bank (Bank for SME Crediting), N.N.

the State never recognized these acts to be as important as several other laws, especially fiscal legislation.

- Four federal programs for small business support were developed – for the years 1994–95, 1996–97, 1998–99, 2000–2001, but financing for the numerous measures of these programs was never found, as a consequence, they were not put into practice.
- An institutional framework for the promotion of SMEs started to evolve at federal, regional and local level in the early 1990ies. The State Committee for Small Entrepreneurship Support (established in 1995) became ultimately responsible for federal government strategy, policies and programs regarding small business support, their design, implementation and monitoring. However, it was dissolved after the upheaval of the August crisis of 1998, and replaced by a department at the Ministry for Antimonopoly Policy and Entrepreneurship Support. The Federal Fund for Small Entrepreneurship Support (reorganized in 1996) became the financial agent for the implementation of federal programs. Similar structures for small business support were established at regional and local level. By the year 1997, about 70 regional funds for small enterprise development had been created and regional programs for SE support were adopted in the majority of regions. However, the programs for small business support (both federal and regional) always suffered from lack of funds, the design of the programs was dominated by a rather administrative approach which was not compatible with the actual demands of SMEs themselves, but rather ‘supply’-driven. Decisions on allocation of scarce state resources and contracts with providers were made in an arbitrary and non-transparent way. There is still a lot of work to be done on the regulatory environment in order to make it favourable to small enterprises. The mechanisms of legislation enforcement are not in place, a lot of provisions have not been put in practice. Thus, in spite of new regulations adopted in 2001–2002, many administrative barriers, excessive bureaucratic requirements and procedures are still in place – especially, at the regional and local levels.
- Currently, the Ministry of Economic Development and Trade is aiming at abolishing the Federal law on small entrepreneurship support because it is ‘inefficient and contradicts a number of subsequently adopted laws’, and the Ministry of Finance is preventing the activities of Federal fund of SME support because it ‘contradicts the Budgetary code’ (our respondent from another ministry said, ‘*several legal treatises were written which all showed that the Law is conforms totally to the Budgetary code*’).

As a consequence, entrepreneurs do not receive any significant support – neither in indirect nor in direct ways and are generally deeply frustrated by the state of the so-called SME support – even more so as appeals to ‘help’ small firms and to ‘support’ the ‘commercial proletariat’, as President Putin has called small entrepreneurship, are very often proclaimed by high state representatives and several political parties.

c. Despite the adoption of a special Law on securing entrepreneurs’ rights by control procedures in 2002, the experts were of the unanimous opinion that ‘the situation has not changed for the better for small entrepreneurs’ and that ‘the oppression of SMEs in regions by the militia and other similar organisations (Financial Police, Department for Combating Organised Crime etc, etc.) is continuing at the same rate’. The militia argues that they are regulated by the Militia Law, and this law was not adjusted when the above mentioned law was adopted. Hence, small entrepreneurs ‘buy’ the good will of militia and other law enforcement organisations, and treat them as the biggest opponent.

d. Some experts pointed out that a lot of very helpful measures to strengthen SMEs and to make the entrepreneurial environment more positive are evident. There is a series of laws that have been passed by the Duma, but which have never been resolutely adopted. The experts argued that the absence of a influential lobby for SMEs in state bodies prevents a more rapid change of the present state of affairs.

However, some experts mentioned that the level of trust among entrepreneurs themselves is now significantly higher than 5–7 years ago; moreover, a certain tendency to self-organisation

in order to protect their own interests and/or to establish credit co-operatives etc. is evident (*'especially among those whose monthly turnover is not higher than 100.000 Roubles'*¹³, according to one expert).

Trust Milieus of Entrepreneurs and other Russians Compared

Two surveys of the Institute of Complex Sociological Investigations of the Russian Academy of Science, Moscow conducted in 2003, which asked a representative cross-section of the Russian public questions related to trust¹⁴, enabled a comparison of some aspects of the trust milieus of entrepreneurs (who were one of the socio-professional groups among the surveyed persons) with the rest of the sample, representing the adult population of Russia. Some of the results of these surveys follow.

Firstly, as Table 71 shows, there are some differences between entrepreneurs and 'common Russians' in relation to trust:

- entrepreneurs have significantly higher trust in colleagues than other groups of Russians (i.e. professional ties are much closer – hence, the level of collective trust is somewhat higher among entrepreneurs than among other socio-professional groups);
- entrepreneurs have significantly lower trust in people with the same problems (because they are more individualistic);
- entrepreneurs have as much trust in friends and relatives as other Russians do – thus, this high-trust milieu is not specific, but rather typical for all individuals within a society with weak collective and/or institutional ties.

Table 71. Whom can you trust nowadays? (Please give all relevant answers from the list below) (in %)

	Entrepreneurs	Entire sample
Colleagues	25.0	16.8
People with the same problems as me	4.5	10.3
Friends	31.8	34.1
Certain political leaders and public persons	-	0.5
People with similar opinions, interests	4.5	3.0
Family, relatives	2.3	25.9
People whom I know	-	0.1
State institutions	-	0.1
Neighbours	-	0.1
Clergymen	-	0.2
People of the same ethnicity	-	0.1
I can trust nobody	-	4.9
Difficult to judge	4.5	3.4

Source: ICSI RAS, The Russian Society on the Eve..., database.

¹³ Ca. 3.000 USD currently.

¹⁴ Wealthy and Poor in Russia at Present. Spring 2003, 13 big economic and geographic regions of Russia, N = 2118 adult persons; The Russian Society on the Eve of the Parliament Elections 2003. Summer 2003, 13 main federal districts of Russia, N = 1759 adult persons. These surveys were conducted as a series of face-to-face interviews based on standardised questionnaires. Both projects were sponsored by the Moscow branch of the Friedrich Ebert Foundation, Germany. For an abbreviated version of the first of the above mentioned projects see: Izvestiya, 29 May, 2003.

Secondly, these differences as a whole are not so great. *Personal trust* in friends, relatives and colleagues is the dominating aspect of trust. *Collective trust* of every kind ('naturally rooted' – ethnicity, confession, or 'idealistically rooted' – opinions, interests, same problems etc.) is relatively low. *Institutional trust* is almost absent. Hence, for instance, the very critical approach of entrepreneurs to state institutions is shared by other groups of population, so the low level of institutional trust of entrepreneurs can only partly be treated as a sign of a low trust milieu between entrepreneurs and State – it is to a great extent a sign of a deep distrust in the State in Russian society as a whole.

Thirdly, however, entrepreneurs consider the trend of changes in the 'rules of the game' in recent years to be somewhat more positive than the sample in general (Table 72). It could be treated as the base for more institutional trust in later periods.

Table 72. How did the situation in the country change during the time of President Putin, in your opinion, as regards: (in %)

Dynamics of change as regards:	Positive changes		Without any change		Negative changes		Difficult to evaluate	
	Entrepreneurs	Entire sample	Entrepreneurs	Entire sample	Entrepreneurs	Entire sample	Entrepreneurs	Entire sample
Efficiency of state governance	26.8	23.2	41.1	36.3	7.1	11.5	25.0	29.0
Situation in law enforcement institutions (courts, Ministry of Internal Affairs, state procurators)	10.5	6.9	56.1	43.0	24.6	27.2	8.8	22.8
Struggle against corruption	8.8	6.6	61.4	43.7	21.1	26.6	8.8	23.0

Source: ICSI RAS, The Wealth and the Poor,... database.

Fourthly, contemporary Russian society is characterised not only by a high level of distrust towards the State, but also by a very small number of commonly shared values, norms, informal rules etc. – so, it is hardly surprising that the level of trust in other people whom one does not know personally, or *collective trust*, is minimal. It is, thus, as low among entrepreneurs as among other Russians (Table 73).

Table 73. Below you find a set of contradicting judgements. Please, choose those judgements with which you would agree: (in %)

	Entrepreneurs	Entire sample
Today one can trust most people	12.9	11.2
One must treat other people very carefully	86.1	88.2
Difficult to judge	1.0	0.6

Source: ICSI RAS, The Russian Society on the Eve..., database.

Fifth, the situation at mid-level is much worse for entrepreneurs than for other groups (Table 74), they are not protected against criminal and semi-criminal incidents; this is a reason for the above critical judgements of State law and order.

Table 74. Have you or members of your family been involved in situations such as the following during the last 2 years? (*Please give all real incidents*) (in %)

	Entrepreneurs	Entire sample
Something belonging to you was stolen (e.g., in the street)	10.5	22.0
Your home, cottage, car was robbed	31.6	15.7
You were shot/ wounded/assaulted	17.5	12.6
Somebody threatened you with physical harm	14.0	7.6
You were forced to give bribes or pay protection money to criminal 'roofs' (<i>krysha</i>) etc.	24.6	3.7
You were forced to make a deal with criminals	3.5	0.8
Other incidents of this kind (what?)	3.5	3.8
None of the above kind of incidents	38.6	55.6

Source: ICSI RAS. The Wealth and the Poor..., database.

The entire environment has to be changed to allow the formation of higher trust milieus at each level – personal, collective and institutional.

Concluding remarks

General considerations concerning the survey and case studies are as follows:

Trust was confirmed to be an important element of entrepreneurial behaviour that could be clearly identified. Most of the persons interviewed did not clearly identify different sides and effects of trust/distrust, but this did not prevent us from summarising some clear indices of different trust forms (personal, collective and institutional) as well as the embeddedness of trust in everyday entrepreneurial transactions and its effect on entrepreneurial behaviour.

However, some facts and figures delivered by the survey imply that the role of trust/distrust – at least of **personal** trust – is not as crucial as it was initially expected to be:

- up to $\frac{3}{4}$ of surveyed small entrepreneurs had no need for trust-based relations during start-up,
- up to $\frac{1}{2}$ of the turnover of their firms is created in the shadow economy, hence, legal trust related procedures and mechanisms were not helpful in *force majeure* situations;
- *personal experience* and *advance payments* play a much more important role than trust when protecting a deal.

The sphere where (personal) trust plays a big role is 'love capital' at the start-up stage as well as credits from informal sources at the following stages of a firm's development: here, because of trust, almost no collateral is used, and these are often no-percentage deals, but in fact subsidies. Established ties with informal lenders, being very useful at initial stages, prevent a change to the legal financial market: the absence of any credit history (hence, of any collective trust based reputation) makes it impossible to borrow money from banks.

It seems to be possible to measure the level of trust and its impact on enterprise behaviour using some indicators that can be calculated on the basis of quantitative survey data. In particular, one might use some indicators of trust based on the survey results, both from a regional and sectoral perspective, to check low and high-trust milieus on the base of a *comparison of following indexes*:

- For *institutional trust* – the percentage of those who estimated shadow business income to be less than 25% divided by the percentage of those who estimated it to be between 75 % and 100 %. (On the basis of question 9a of our questionnaire)
- For *personal trust* – a series of indicators:
 - between the firms and established suppliers/customers/ business partners – the share of those who had to cover all or more than half of the value of loan with collateral divided by the share of those who did not have to do so at all or covered less than half the loan (Personal trust to established partners, PTEP), on the basis of question 10c
 - the share of those who offer credits to customers divided by the share of those who only act on the basis of cash on delivery or bank transfers (Personal trust to customers, PTC) on the basis of question 16d
 - the share of those were offered credits by suppliers, divided by the sample (reputation indicator, RI), on the basis of question 17c
 - the share of those who rely on familiarity with partner when offering a loan, divided by the share of those who prefer advance payment and of those who rely on guarantees (New business deal trust indicator, NBDTI), based on the question 28.

All of these indicators can be calculated by *sector, region, age group etc.* This is therefore a sufficient basis for comparisons of any kind – cross-sectoral, cross-regional and cross-national. However, the sample of our project was too small to make any generalised calculations.

It might be possible to differentiate regions or sectors according to their ‘level of trust’, for example on the basis of the aforesaid indicators. The evidence of the qualitative approach and comparison (all the more since collective trust especially cannot be studied merely in a quantitative manner) to some extent contradicts initial assumptions concerning the role of regional differences in the establishing of local trust milieus (Table 75).

Table 75: Trust milieus in the surveyed regions: common issues and differences¹⁵

<i>Differences between regions</i>	<i>Similarities between regions</i>
Importance of trust in relations with business partners (significantly more important in Kaluga/Voronezh, less important in Nishny Novgorod/Moscow)	Groups – native regions, ethnic, confessional etc. – preferred in business transactions (mainly established business partners + no preferences, except for Kaluga: people from Kaluga after established business partners, people from native region 2 nd preference)
Criteria of employees selection (Moscow: experience + personal knowledge, Kaluga /Nishny Novgorod: experience + recommendations, Voronezh: experience + skills)	Types of agreements with customers/clients (only in Voronezh no agreements with customers 2 nd ranked, in all other regions – written contracts, oral contracts, no agreements)
Sources of assistance in complicated situations (in Moscow & Voronezh – no assistance needed + established business partners, in Kaluga & Nishny Novgorod – family & friends + established business partners)	Payment terms for customers (except Kaluga: high percentage of credits for up to 1 week, all other regions – mainly cash on delivery and bank transfers)

¹⁵ By comparing SMEs from different regions, we described as *similarities* such cases when at least in three of the surveyed regions the composition of their responses was more or less the same. we characterised as *differences* cases where the structure of responses was totally different between at least two ‘groups’ of regions.

<i>Differences between regions</i>	<i>Similarities between regions</i>
Help from any side during start up stage (Moscow/Kaluga – more often recipients of any forms of help, Nishny Novgorod/Voronezh – mainly no help from everywhere)	Lending money to third persons (except Moscow where friends & family are 1 st ranked, in all other regions – employees)
	Relations between private firms and authorities (mostly neutral, except Kaluga: more critical approach towards any levels of state and different state institutions)
	Cooperation areas (minimal role in every possible form)
	Relations to persons in several inspecting state bodies (everywhere neutral/friendly)

This comparison shows that, first, there are in fact more similarities than differences between SMEs in the surveyed regions. Second, the locally based nature of these differences and disparities is to some extent arbitrary – they may be determined by some other factors than location (the samples were too small, the structure of the samples in all 4 regions was different as regards sector, age, size etc.). On the other side, similarities between statements made by SMEs in different regions may be the product of some more general trends.

These trends, or at least some of them, contradict our initial assumptions. These trends may be described as follows:

- If we go beyond some verbal statements of interviewed entrepreneurs regarding their over-emphasizing of the role of personal trust in relations with business partners, customers etc. or money lending practices, we may see that their *actual behaviour is governed by factors other than personal trust*. In fact, personal trust – though it is very important in *force majeure* situations or during start-up, plays a much more modest role than we assumed initially.
- Despite harsh criticism of institutions and verbally expressed distrust of the state, institutionally based practices are well embedded and accepted (preference of written contracts even with established partners, bank transfers, initialising of prosecution by the courts or courts of arbitration in *force majeure* cases etc.). Hence, the widespread opinion that *institutional trust* in Russia is underdeveloped must be corrected.
- Contradictory to our initial assumptions, there are no *collective trust* milieus in sight – neither based on any form of local, ethnic or confessional ties, nor on any form of co-operative economic behaviour or membership in business associations etc.

It is hardly possible to identify the interdependencies between the role of trust and other factors (constraints) influencing enterprise behaviour on the basis of the survey data, with a few exceptions (for example, for new business deals, see question 28).

Generally, we did not include any questions in the questionnaire concerning changes over time. The only opportunity to do this was the interviews, where some entrepreneurs compared the situation now with that some years ago and drew some conclusions (which we have to evaluate). That is why *processes of growth or decline of trust were not discernable*. However, statements both from entrepreneurs themselves in the in-depth interviews, and from representatives of the state and public institutions (experts), on the whole indicated that trust is growing, even vis-à-vis some of the state bodies (court and court of arbitration).

For the most part, the owners and managers interviewed accepted the importance of researching trust. Many of them even over-emphasized it to some extent – what could be explained as a certain lack of entrepreneurial know-how (in such cases trust is certainly extremely important – other patterns are either absent or not reflected).

Despite the fact that it was possible to analyse forms of trust on the basis of the survey as well as on that of the interview, there are a lot of ‘overlapping’ fields, i.e. evidence explaining the complex character of trust, where some issues could be seen as signs of more than one type of trust:

- *A marketing strategy based on reputation* – an overlap of personal and collective trust (based primarily on individual trust. However, the striving to be fair is not only motivated by the desire to look good in the eyes of a concrete partner, but also to be viewed as someone who is ‘well-intentioned’ in the entire area [local, sectoral etc.]).
- *A protection strategy against breaking of contracts based on the law – collective and institutional trust* (when based on common law, formal law can function perfectly. In transitional environments, however, the law usually either contradicts old ‘common law’ practices or formal law is obsolete and does not reflect actual practice any more. When, unlike the situation in Russia today, law is based on actual practice, statements such as ‘I could never enforce a court decision against somebody whom I have sued, hence, let us rely on ‘good will’... cannot reflect the norm. On the other hand, when an obsolete law contradicts the terms and rules of commercial practice, conventions play a big role (e.g., as regards the employment matters in Russia).
- *Calculated risk in entrepreneurial decision making strategy – personal and institutional trust.* Only in societies where a person is viewed as a legitimate actor, do written law and other such institutions have a role to play. Entrepreneurial decisions of individuals can be rational only within a predictable legal environment. Society must treat individuals as a major player, and individuals must be able to rely on transparent rules etc.. In transitional economies, however, the state distrusts people (several restrictions in the tax policy, abusing control of SMEs etc.) and people do not trust measures or policies of the state (hence, only short term business planning, no investments etc.).
- Within the field of *secure contractual practice* all the three levels of trust overlap each other. This can be sustainable only in the case when individuals are acting on their own, and both collective and institutional trust are high.

The role of trust in the establishment and development of lasting business relations differs, depending on, e.g., sector. The role of trust depends on how big the circle of potential suppliers and customers is: the smaller the niche, the more one trusts one’s partners, as a breach of contract can undermine the reputation one has in the small circle of firms that know each other well, with possibly serious consequences. In such small networks ‘personal trust’ is supported and shored up by ‘collective trust’ (i.e., the realisation that even competitors would not do business with a firm that has behaved unfairly towards one’s own company). In other areas – especially the wholesale trade with standardised goods – trust has to be created by economic techniques (rebates, additional services, etc.) and extended and reinforced by confidence-building measures.

The survey and interviews showed that the times when ‘personal trust’ rested mainly on family and friendship ties are long gone. People have realised, often thanks to bitter disappointments, that business and private life have to be kept separate. This means that nowadays good personal relationships and ‘personal trust’ arise because of business relations that have been established spontaneously and been successful for a while, not the other way around, as it was common in the early 1990s. This means that the ‘social capital’ of an entrepreneur is not measured by how many businessmen he knows from old times, but by how skilfully he handles marketing and logistics, and whether he can use this to create functioning networks. Many admitted that ‘personal trust’ in regard to permanent business partners or even friendship that arose out of business relationships differed from ‘friendship per se’.

In the regions investigated, the market today is a customer's, not a supplier's market. Therefore, business relationships with trustworthy customers, rather than with suppliers, acquire special significance. For this reason, suppliers have to create ties to customers by purely economic means, whereas special emphasis is placed on confidence-building measures when establishing and cultivating permanent relations with clients (birthday presents, help in establishing new business contacts, etc.). Relationships with customers, as well as with new partners, are those zones of entrepreneurial behaviour which are especially trust-related. Although contracts are mostly regulated by written agreements etc., this is to a large extent a consequence of formal fiscal rules, not so much of the desire to protect oneself from commercial risk.

Ethnic, confessional and local ties play next to no role, with one exception: the significantly lower willingness to do business with people of Caucasian ethnic origin. Apparently both a significant difference in mentality, which is expressed by a disregard of the conventions accepted in Russia (business practices are interpreted completely differently by Caucasians – e.g., making minor concessions is not seen as an opportune business practice but rather as 'weakness' and therefore does not lead to a service in return, but rather a hardening of one's own position), as well as chauvinist views exacerbated by the events in the Northern Caucasus and the tragic taking of hostages in the Moscow theatre play a role in this.

On the whole, there is very little presence of intermediaries: associations and unions of entrepreneurs play no role; neither do the 'out-of-court arbitration procedures' so popular in the early 1990s moderated by semi-criminal 'kryshas' ('roofs') – these were not mentioned by any of the interviewees. This is probably due to the fact that very short-term business strategies (getting rich quickly by cheating the business partner and then 'doing a runner') and the corresponding type of 'entrepreneur' are finished.

The institutional environment remains uncongenial. This holds true especially for legislation and for the control exercised by various regulatory and administrative state institutions.

Institutional trust is either non-existent or close to zero – if one is to believe entrepreneurs' statements. However, some facts contradict this statement: the greater role of written contracts, the belief in courts and courts of arbitration (and not in 'roofs' as institutions of 'alternative judgement' as was the case in the early 1990s) etc. It is the unpredictability of the authorities' policy and legislation that leads to distrust. The respondents attribute this circumstance to the fact that there are no officials capable of understanding business motivation or who are familiar with the capabilities of business 'from the inside'.

We hold the following conclusions to be true.

- The provisionally formulated theories of the role of 'invisible hand of personal trust' in Russian small scale economy based on certain empirical findings of the early 1990s should be modified;
- This is also true for the overemphasizing of the influence of local environments on the structure and character of trust milieus of Russian SMEs.

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